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VOL. XXII *June · 1952* NO. 6

• **Motor Carrier Accounting**

An Outline of the I.C.C. Accounting Regulations—*Paul Safro, C.P.A.* 329

The Problems of the Motor Carrier Accountant—*Joseph L. Mehr, C.P.A.* 332

• **Federal Income Taxation**

The New Federal Income Tax On Savings Institutions—*Matthew F. Blake, C.P.A.* 338

Do Gifts of Farm Products and of Mercantile Inventory Result in Income to the Donor?—*Edward T. Roehner, C.P.A.* 347

• **The "Funds" Statement on the Cash Basis**—*John N. Myer* 355

• **Your Career Goes into Production**—*Harold R. Caffyn, C.P.A.* 358

• **Departments**

New York State Tax Forum—*Benjamin Harrow, C.P.A.* 365

Employees' Trust . . . Capital Gain Dividends . . . Unincorporated Business Tax—Allocation . . . Unincorporated Business Tax—Officer of Several Real Estate Corporations . . . Unincorporated Business Tax—Allocation . . . Income Tax—Proration of Exemption of Husband and Wife . . . Income Tax—Deduction for Taxes . . . Income Tax—Gain on Sale of Residence . . . Head of a Family Status . . . Medical Expense Deduction . . . Deduction for Charitable Contributions . . . Limited Recognition of Gain in Corporate Liquidations . . . Impact of Section 354.9a on Dissolutions of Real Estate Corporations.

Notes on the New York State Unemployment Insurance Law—*Samuel S. Ress* 371

Voluntary Coverage . . . Experience Rating Initial Account Balances . . . Joint Accounts . . . Limitation of Collection of Contributions, Interest and Penalties . . . Joint Employment.

Office and Staff Management—*Max Block, C.P.A.* 374

Advice to Clients Re Life Insurance Uses . . . Bulletins to Clients . . . Spiral Bindings . . . . . Improvement in Report Writing . . . Mailing Returns to Tax Department.

The Excess Profits Tax Exchange—*David Zack, C.P.A.* 376

Acquisition of Stock for Cash in Part II Transactions . . . Installment Basis and Long Term Contract Taxpayers.

Book Reviews 322, 328, 378

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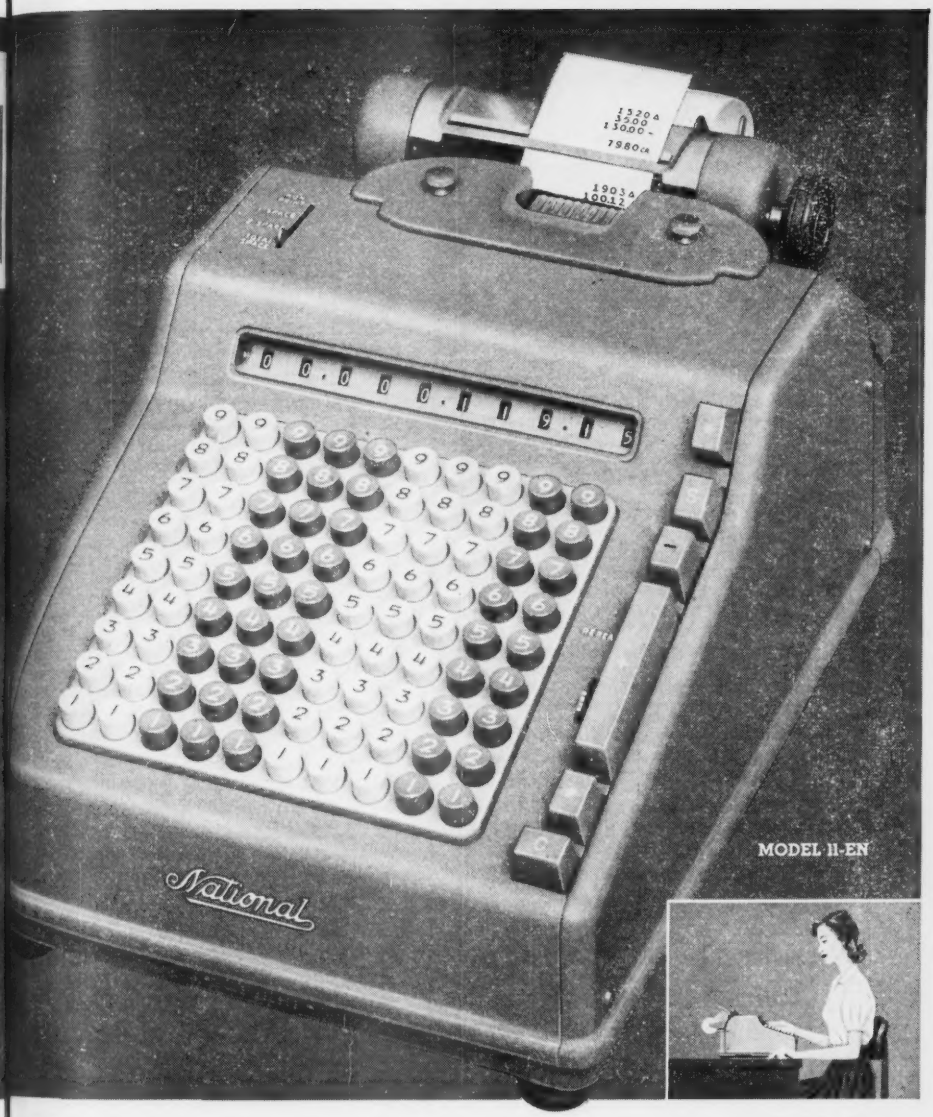

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(Continued on page 327)

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(Continued from page 326)

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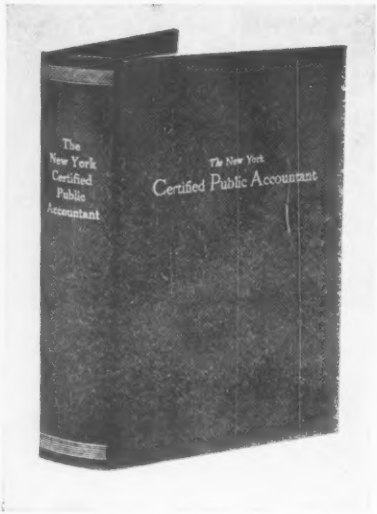

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Book Reviews

(Continued from page 322)

There are few in the profession well qualified to understand and handle the many complex questions that confront the farmer as to the proper record-keeping which will permit the ready filing of a tax return when it becomes due. Mr. Monatt's handbook is concise and clear, it deals with farms owned both individually and in partnership. The basic methods of the preparation of tax returns on both a cash and an accrual basis are shown separately. All necessary specimen forms and schedules are included in this book. The forms and schedules are filled in and detailed explanatory notes are presented. Such subjects as records to be kept, farm capital assets, carry-back and carry-forward, joint returns and splitting the income of husband and wife, buying or selling a farm, death of a farmer, etc., are covered in this book. It includes detailed check-lists of things to remember, and a comprehensive topical index.

However, it seems to me that to start this book with Form 843—Claim for Refund—is in poor taste. The implication is there that, if the farmer will follow the author's income tax guide, he might quite well wind up by filing Form 843. It is too bad to attempt to sell a good book by inserting a fishhook on the first page.

It is also a pity that Mr. Monatt talks down to his prospective farm readers. To this reviewer, it seems that one of the bases of good writing is to treat one's readers as adults, certainly not to be cute. To quote: "Farm income taxes should be treated in the same manner as the farmer treats his farm. In other words, they should be 'planned', 'planted', 'cultivated' and 'reaped'. The 'planning' should be done in advance of the taxable year, the 'planting' and 'cultivating' during the taxable year, and the 'reaping' when you file the farmer's return." Likewise, such meaningless language as: "Thus, you 'plan' your income taxes under 'Choice in Reporting Income and Expenses'; you 'plant' under 'seeds for Tax Planting—Tax Savings'; you 'cultivate' to final harvest by the tax know-how of all the farm tax transactions. The result: you 'reap' tax benefits." Could it be that Mr. Monatt means that the farmer should properly watch and record his farm transactions so that he can guide his business in a manner which will result in the proper payment of taxes?

WERNER E. REGLI

Mahopac, N. Y.

(Continued on page 378)

THE NEW YORK
CERTIFIED PUBLIC ACCOUNTANT

EMANUEL SAXE, *Managing Editor*

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VOL. XXII *June • 1952* No. 6

An Outline of the I.C.C. Accounting Regulations

By PAUL SAFRO, C.P.A.

This article presents, in capsule form, an outline of the I.C.C. accounting regulations regarding prescribed accounts, records and statistics, as well as required examination and reporting procedures.

THE I. C. C.—the Interstate Commerce Commission — started its regulation of companies carrying property and passengers on June 1, 1938. Accounting Regulations were issued which control in detail the accounting requirements of carriers subject to the Commission's control. While the set-up of accounts generally applies to all types of common and contract carriers of property and passengers, this discussion will be limited to common carriers of property, only.

Classifications of Common Carriers

All carriers are divided into three major classifications, based upon the annual volume of business, as follows:

Class I—Annual volume of $200,000, or over.

Class II—Annual volume of $50,000 or more, but less than $200,000.

Class III—Annual volume of under $50,000.

PAUL SAFRO, C.P.A., is a member of our Society, the American Institute of Accountants, and the Federal Tax Forum. He heads an accounting firm under his own name.

He is a member of the Committee on Land Transport Accounting, under whose auspices he read this paper at a technical meeting held on December 18, 1951, at the Engineering Societies' Building in New York City.

Balance Sheet Accounts

The Commission publishes a booklet known as the I.C.C. Uniform System of Accounts, obtainable at the Government Printing Office, Washington, D. C., for twenty-five cents. In addition, there is also available a loose-leaf service, on the style of tax services used by accountants, published by the American Trucking Associations, Inc., of Washington 6, D. C.

Generally speaking, this uniform system, like many other classifications of accounts, is divided into balance sheet accounts and profit and loss accounts. There is, also, a mixed account used for inventories. All accounts are numbered in accordance with the Dewey Decimal System. Thus, at a glance, one can tell by the first digit of the number, the group of assets into which a particular account falls. For example: Accounts Receivable is num-

bered 1120. One represents assets, eleven represents current assets, and so forth.

The balance sheet accounts are similar to those used by any other mercantile concern. All accounts whose numbers start with 1,000 represent assets. Those with 2,000 represent liabilities; 2,700—capital stock; 2,900—surplus. It is interesting to note that pre-payments are classified as deferred debits. Beginning with January 1, 1952, this becomes a current asset. This interpretation follows the recent ruling published by the American Institute of Accountants which classifies all prepayments which materialize within one year as being in the nature of current assets.

Profit and Loss Accounts

The set-up for profit and loss accounts is rather different from that of the average mercantile concern. The income account, known as Operating Revenues, is the equivalent of the Sales account. The expense accounts, however, are different. To understand more clearly the basis for the classification of the expense accounts, one needs to bear in mind the actual operation of the trucks, engaged in the task of picking up and delivering freight.

Expenses in connection with the equipping of the trucks in the garage and putting them into shape for over-the-road operation are charged to one group of accounts. Once the truck is equipped for over-the-road operations, it starts to roll. Therefore, all expenses incurred on the road are charged to another group of accounts known as transportation expenses. Once the truck arrives at its destination, all of the expenses necessary to the ultimate delivery of the freight and the maintenance of terminals are charged to still another group of accounts.

Aside from the foregoing classifications, traffic and selling expenses are charged to another set of accounts. Then, we have insurance expenses, administrative and general expenses, and so on.

Space limitations do not permit me to go into a detailed explanation of all the accounts. However, a general understanding of the preceding description followed by a reading of the uniform system of accounts should enable any accountant to understand this system fully.

Report Requirements

The books of account must be kept on a calendar year basis. The carrier may elect to file tax returns on a fiscal year basis but the books, nevertheless, must be kept on a calendar year basis. This is one of the many differences between tax procedure and I.C.C. accounting.

The Commission requires that quarterly reports be filed with the regional office on or before the last day of the first month following the close of each one of the calendar quarters. These reports cover only profit and loss items and major statistics. No balance sheet items are required to be filed with these reports. In addition, once a year, on or before March 31, an annual report must be filed with the national office of the Interstate Commerce Commission, Washington 25, D. C. This annual report is quite voluminous in its detail.

I.C.C. Examinations and Requirements

The books and records of the carrier must be kept on the premises of the concern at all times. The books are examined regularly by I.C.C. auditors. In addition to the regular books and records, all supporting data must be kept on file, available to the I.C.C. examiners. The supporting data include items such as trial balances, schedules supporting each one of the real accounts (such as plant ledgers, prepayments, etc.), and data supporting monthly accruals.

The Commission is very strict regarding the recording of all the ac-

cruals in the respective months. If necessary, it recommends adjusting general ledger accounts in accordance with schedules every single month. Thus, it is very important to record monthly charge-offs for items like depreciation, insurance, taxes, licenses, interest, tires and tubes, and other items. It is important to note that the cost of tires and tubes applied to revenue equipment, whether used for new or old equipment, is charged to the account of prepaid tires and tubes and charged off to an expense account known as Tires and Tubes, No. 4160, in appropriate monthly installments.

Recurring Journal

All of this can be accomplished very easily by the use of a recurring journal utilizing columnar sheets. The accountant may conveniently set up his accounts (names and numbers) in the explanation column, and use twenty-four columns across, two for each month, to show the amounts for debits and credits. It has been found from experience that the easiest way to keep an accurate record of the details of the monthly charge-offs is to keep a set of columnar sheets; one sheet for each one of the items, showing the total expenditure to be written off in the first column and the monthly charge-off in each one of the following columns.

Even corporation and franchise taxes based on income for the current year must be charged off monthly on the basis of the best available estimates. In this manner, there are very few adjustments left at the end of the year. The average monthly trial balance necessarily represents an annual closing.

Statistics

The Commission also requires that a complete record be kept of certain statistics. These statistics consist of weight, miles traveled over the road, ton-miles, hours of work, and others. The best way for the accountant to control the accumulation of these statistics is to have them posted to a special statistical record book. In that way, the statistics are always up-to-date and the information is fully available for the preparation of the annual report.

Conclusion

It is fair to say that I.C.C. accounting requirements are nothing less than good accounting, the type we like to see observed in all business concerns. An industry, many of whose members only a little more than a decade ago did not even keep a good check book, serves today as a model example of what accounting regulations can do. Even statistics can be usefully interpreted for the benefit of sound and profitable operations.

The Problems of the Motor Carrier Accountant

By Joseph L. Mehr, C.P.A.

This paper discusses some of the more important problems confronting the accountant in this regulated industry. It was written by a man who has devoted the greater part of his professional life to this field of accounting.

The problems of the motor carrier accountant will be discussed with particular regard to the smaller carriers. As I see it, the problems of the motor carrier accountant may be summarized as follows:

1. Governmental regulation of the entire motor carrier enterprise.
2. Physical operations of the motor carrier.
3. Working capital and capital investment.
4. Uniform system of accounts.
5. Intangible property.
6. The annual report.

1. Governmental Regulation—Interstate Commerce Commission and the Various States

The complete regulation of the motor carrier by the Interstate Commerce Commission and the various States through which the carrier moves, is one of the most difficult concepts for the accountant to understand. In the East, all of the States have their separate Public Utility Commissions, whose regulations may be entirely different from those of the Interstate Commerce Commission. Only in New Jersey are motor carriers of property exempt from utility commission regulation.

The need for regulation was felt prior to 1935, when the motor carriers were engaged in vicious competition, while the public was subjected to abuses of long delays in delivery of freight, excessive rates and charges, no insurance for losses and damages, and unsafe vehicles on the highways.

In addition to accounting regulations, which are discussed under "Uniform System of Accounts," the principal subjects of regulation are as follows:

Individuals controlling the motor carrier must prove their past experience in that type of business.

One motor carrier, or any individuals controlling it, cannot acquire another motor carrier, except by permission of the Commission, and a showing of public convenience to be served by such acquisition.

The carrier must adhere strictly to the operating authority granted—if regular routes are mentioned, no deviation therefrom is permissable; or if irregular routes are stated in the order granting operating authority, it must confine its operations to that area.

The operating authority may limit and restrict the commodities to be

Joseph L. Mehr, C.P.A. and attorney, is a member of our Society and of its Committee on Land Transport Accounting. He is also a member of the Metropolitan Society of Motor Carrier Accountants.

Mr. Mehr was formerly senior accountant to the New York State Public Service Commission and later, district accountant and examiner for the Interstate Commerce Commission. He is now engaged in public practice as a motor carrier accountant.

This paper was presented by Mr. Mehr at a technical meeting of the Society held under the auspices of the Committee on Land Transport Accounting on December 18, 1951, at the Engineering Auditorium in New York City.

hauled to specific commodities. It may also provide for no compensation on the return route. The reason for the limitations on a carrier's operating authority is the extent of its proof of operations on June 1, 1935, the "grandfather" date of Interstate Commerce Act regulating motor carriers in interstate commerce.

Rates to be charged are restricted to the tariff filed by the carriers and such rates are subject to suspension and attack, if they cannot be proved to be compensatory, or if they are included for competitive purposes to take away business previously carried by another carrier.

Insurance regulations require cargo insurance and public liability damage insurance certificates to be filed for the protection of the public. The carrier will determine his cargo insurance by the value of his shipper's commodities on a truck, but his property damage and public liability insurance requirements to a large part are based on its and other carrier's experience. Prior to the Holland Tunnel explosion, caused when a truck caught fire, $50,000 property damage seemed sufficient for such a risk.

Safety regulations are imposed with respect to the vehicle—brakes, lights, etc., and to the drivers with respect to their hours of service. A driver may not drive more than ten hours in one day or, if it is a continuous trip, must rest eight hours before continuing the next ten hours of driving. He must keep a log of his trips indicating driving, rest stops, sleeping in berth and the crossing of State lines.

2. Physical Operations of the Motor Carrier

The motor carrier accountant should familiarize himself with the physical operations and the resulting statistical data that are based on such operations, and which affect the carrier's income.

What are the principal routes operated by the carrier and the principal cities served?

Does the major traffic move one way only or is there a balanced movement of freight so that the greatest use is made of the equipment and vehicles?

Who are the main shippers? Does the carrier depend on them for his steady flow of freight? How is the credit standing of shippers determined?

What are the principal commodities hauled? Are they bulky, so that their weight does not compensate for the space they consume in the vehicle.

Is the equipment that is operated adaptable to the commodities hauled, or is it too heavy or too light for such freight.

Are there any particular traffic problems with respect to city operations, which would increase the operating costs such as, paying loaders to load and unload the freight on steamship piers, waiting in line at the piers, city traffic regulations as to one-way streets, parking, etc., resulting in excessive overtime, and claims arising from thefts and damage to freight.

What is average revenue per ton of freight hauled? This is an important figure for comparative purposes since it determines the type of freight carried. A lower revenue per ton might be due to larger truck load shipments, but with less overhead expense, because of no platform handling and only one delivery. A higher revenue per ton might be too costly in that it would entail more platform labor and considerable time in effecting deliveries.

The revenue per mile will determine the extent of the use of the vehicles by percentage of capacity and as a comparative figure, will determine the net operating revenue where the cost per mile is ascertained from fixed and variable costs.

Other items respecting the physical operations which should be known to the motor carrier accountant are—the terminal costs; costs of pickup and delivery within the terminal city; the problem of whether to use owned or rented trucks for city deliveries; labor union contract conditions regarding rate of pay, overtime, vacations, pension and hospitalization benefits.

3. Working Capital and Capital Investment

The working capital of a motor carrier differs from that of a merchandise or trading concern in that there are no merchandise inventories. Furthermore, its tangible property or fixed assets take on the semblance of current assets since they take the place of the merchandise held for sale by the trading firm.

Prior to January 1, 1952, the current assets of a motor carrier consisted of cash, receivables (currently collectible) and material and supplies on hand. The current liabilities consisted of notes payable within one year, accounts payable, wages, taxes, and accrued liabilities.

The working capital picture of most carriers would show current liabilities considerably in excess of current assets. This picture has been somewhat bettered by the inclusion from January 1, 1952, of prepaid items, such as insurance, taxes and licenses, rents, etc., which were previously listed as deferred debits on the balance sheet. The cause for the lack of working capital is that the receivables represent about one-half of the month's billings, while the payables are at least one full month's invoices, one week's wages, from one to three months of payroll taxes, and notes payable due from one to twelve months. Cash is limited because it is generally needed to pay off monthly equipment note obligations not included in current liabilities but in long term liabilities, and to meet the down-payments of ten to twenty per cent on purchases of new equipment.

For example, a motor carrier grossing $25,000 monthly, might show his working capital as follows:

CURRENT ASSETS	
Cash	$ 2,500
Accounts Receivable	12,500
	$15,000
CURRENT LIABILITIES	
Notes Payable	$ 5,000
Accounts Payable	10,000
Wages Payable	3,000
Payroll Taxes	1,000
Other Current Liabilities Rent, Insurance, etc.	2,000
	$21,000
Deficit in Working Capital	$ 6,000

The inclusion of prepaid insurance, taxes and registrations after January 1, 1952, might wipe out the deficit in working capital, but still leave no actual working capital.

The shortage of working capital is due to various reasons. Trucks, tractors and trailers are purchased on terms calling for ten to twenty per cent down-payment and notes over eighteen months to three years. The depreciation rate on such equipment is from four years to eight years. This causes a constant drain in cash, necessitating borrowing or deferment of other current liabilities.

Why this lack of working capital? Primarily, because the actual capital investment originally made was small and was never increased. The current profits have not been sufficient to meet the expansion needs for equipment, terminals or purchases of other motor carrier operating rights or firms.

Originally, the business could be started with capital sufficient for about two weeks wages, the down-payment on one or two trucks and the insurance deposit. The remaining capital needs

were left to bank credit and profits. It was a one-man business and did not attract investors from the outside or even from its own employees.

The remedy for this lack of capital is to broaden the distribution of stock or issuance of bonds. The writer has for a long time recommended the issuance of long-term bonds with a profit participation clause in addition to the interest. This should be especially attractive in view of the high corporate income and excess profits tax rates, where all interest paid is deductible. For example, a carrier recently offered ten-year income participating 6% bonds with an additional 1% when the profit before taxes reaches $50,000 and a further 1% when the net profit reaches an amount equal to the excess profit credit.

These bonds could be marketed by sales to employees, especially key employees, by means of weekly or monthly payroll deductions. This would serve the double purpose of giving additional income to the employees and of retaining his interest and loyalty in the firm.

4. Uniform System of Accounts for Motor Carriers of Property

Once the concept of governmental regulation of the motor carrier is mastered, it is not too difficult for the accountant to understand the objectives of the Uniform System of Accounts prescribed for motor carriers having gross annual revenues in excess of $200,000.

To the regulatory body, quarterly and annual reports based on the Uniform System of Accounts, furnish the cost of operations of carriers by regional groups; by classifications of carriers such as general commodities, household goods, heavy machinery. This affords publication of such reports and summaries, and furnishes valuable comparative figures for the individual motor carrier.

To the accountant, it furnished him with a chart of accounts which can easily be followed after application to the general books and books of original entry. Any questions of proper accounting under the system of accounts can be referred to the district accountant of the Interstate Commerce Commission or to its Bureau of Accounts and Cost Finding at Washington, D. C.

Without going into the details of the system of accounts, it presents departmental analyses of expenses, such as the maintenance expenses, terminal expenses, sales and traffic expenses, insurance and safety expenses, general and administrative expenses, depreciation, and taxes and licenses to complete the operating expenses.

The more cost-minded motor carrier accountant would prefer the system of accounts along functional lines, such as the line-haul or over-the-road costs separated from the city or pickup and delivery costs. Others prefer to analyze all income and expense by individual units, adding overhead costs to the direct costs. For rate purposes and rate hearing applications, it is necessary to go beyond the scope of the Uniform System of Accounts to develop costs for handling particular commodities between specified points.

The accountant notes, from the instructions prefacing the Uniform System of Accounts, the variances between ordinary accounting for tax purposes and accounting as prescribed in several instances, as follows:

(a) Profit or loss on trade-in of old equipment on purchase of new equipment.

For tax purposes, the profit or loss on old equipment is applied to the cost of the new equipment to increase or decrease the actual cost of the new equipment.

The uniform system of accounts requires the old equipment to be retired and the excess of the accrued depreciation plus trade-in allowance over the cost thereof is credited to an expense account styled "Depreciation Adjustment," on the theory that there was no actual profit, but only an over-accural of depreciation. The converse is true

where a loss is sustained. This variance between I. C. C. and tax accounting may require separate records to be maintained reflecting cost and depreciation for each basis.

(*b*) *Depreciation of Revenue Equipment—Trucks, Tractors and Trailers.*

For tax purposes, the entire cost may be recovered through depreciation, and the unit need not be reported after it is fully depreciated.

Under the Uniform System of Accounts, only the service value can be recovered, that is, the cost less reasonable salvage value. Furthermore, while the Commission has as yet not prescribed rates of depreciation, it requires a periodic review of the rates of depreciation where it is evident from the carrier's annual report that the basis used is too rapid or insufficient. All equipment owned must be continued on books even if fully depreciated.

(*c*) *Cost of Tires on Equipment Purchased.*

The Bureau of Internal Revenue has agreed with the Interstate Commerce Commission that tires on new equipment purchased may be deducted from the cost of the equipment and charged directly to expense, since the life of the tires is one year or less, while the equipment has a life of four years or more.

It is mandatory under the system of accounts to exclude the tires from the cost of new equipment, but they may be charged to expense directly or prorated over a period from "Prepayments—Tires."

Other items peculiar to the regulatory accounting system are:

(*d*) In a sole proprietorship or partnership, a reasonable amount must be recorded as the *salary of the owner or partners.*

(*e*) *All accruals,* including depreciation, insurance, payroll taxes, corporate and income taxes, rents, etc., must be recorded on the books *monthly.*

(*f*) *Monthly trial balances* must be maintained and all entries for the current month must be recorded within thirty days after the close of the month.

(*g*) *A C.O.D. Register* must be maintained, for the recording of the receipt of the C.O.D. money due to the shipper and the specific payment therefor to the shipper.

(*h*) *A Cargo Claim Register* must be maintained, listing every cargo claim received and its disposition. This enables the carrier to compute his credits to the cargo loss and damage reserve with contra charges to expense. However, for tax purposes only actual claims paid may be included in expense.

The accounting regulations under the Uniform System of Accounts are mandatory, not only for the quarterly and annual reports to be filed but for the periodic examinations made by accounting examiners of the Interstate Commerce Commission.

5. Intangible Property

It may be a paradox, but the intangible property of a motor carrier is more tangible than its actual tangible property or equipment. The intangible property does not depreciate in value, but instead its value increases each year. The carrier's operating authorities or franchises granted by the Interstate Commerce Commission or State Utility Commission are usually for a perpetual term, provided the carrier performs its transportation service. The carrier may sell its franchise, subject to approval of the Commission. Because no new franchises may be granted, except on proof of public convenience and necessity, the existing franchises become more valuable, particularly where the large industrial areas are served.

On the Balance Sheet, the intangible property may not appear at all, except for the actual cost of hearings on the application for the authority granted. Even when a substantial sum is paid by one carrier to another for the franchise, the cost thereof must be written off within a few years at most.

The goodwill of the motor carrier is not reflected on the books. In a motor carrier it does not necessarily represent the flow of profits, but the average dollar revenue of the carrier, on the theory that it costs from ten to fifteen per cent of the revenue to develop it into average fixed revenue for the carrier.

In my opinion, the value of the carrier's intangible property should be noted on the balance sheet as a footnote to influence the values in the same way as the stock market reflects the value of a listed company, that is, the price a willing buyer would pay therefor. Why shouldn't the motor carrier's financial statement reflect the true value of the company?

6. The Annual Report

The annual report of Class I Motor Carriers of Property to the Interstate Commerce Commission consists of some eighty pages and should be awarded the first prize for its bulkiness and multitudinous folderol. As Jimmy Durante says, "Everybody wants to get into the act." So with the annual report; any additional data that some other government agency or group desires are added to the report each year, so that in time it may be so bulky that its usefulness will be completely eliminated.

The Labor Department wanted some data on wages and hours and average wage, so a schedule was inserted showing for each class of employees the average number of employees, the total compensation, average wage and total man-hours or days paid for. A group wanted to know the cubic capacity of each truck and trailer, so an additional column was added. Now there is pending an order requiring the carrier to classify and report his revenue and tonnage by some three hundred commodities.

Primarily, it contains the corporate information on directors, officers and stockholders, the balance sheet, income statement and schedules to support main items in each. Then follows a schedule detailing each unit of revenue equipment—trucks, tractors and trailers, or by group only if the group is of the same type and purchased at th same time and identical in cost. Not only are all the units listed but the weight, carrying capacity, cubic capacity and (added within the last few years to furnish data for a study) the salvage value, life and depreciation charged for each unit during the year.

Following the accounting schedules and the wage schedule referred to, come the detailed statistical schedules. Some relief on statistics has now been given to carriers whose gross average revenues are under $500,000. Where a carrier maintains a statistical staff or punch card records, it is quite possible to get fairly accurate figures. But for the average carrier, the computation of ton-miles and the revenue per ton-mile is based on the most part on imagination. The ton-mile is the distance one ton moves. If all the tonnage moved only from New York City to Philadelphia, Pa., the ton-miles would be tons times 90. But where tonnage is hauled between as many points as there are municipalities, then it means taking each freight bill and multiplying its weight by the miles it traveled. Short cuts and studies for a number of days are suggested in compiling the schedules, but the results are too far from accurate to be used by the industry.

In conclusion, the motor carrier accountant should avail himself of all the information and regulations respecting the carrier he represents in order to carry out his responsibility.

If the motor carrier is to be classed as a public utility, it should be so treated, without the additional burdensome taxes imposed by the States for using its highways and should be relieved in part of some of the detailed reports required by the regulatory Commissions.

The New Federal Income Tax On Savings Institutions

By MATTHEW F. BLAKE, C.P.A.

Savings type institutions face a number of unique problems in this, their first year of taxability under the Internal Revenue Code. This paper reviews the more important topics and comments on the impact of the new legislation on accounting and investment policies.

THE enactment of the Revenue Act of 1951 signalized the opening of a new, if not happier, era in savings bank operation. Section 313 of that law in disarmingly simple language injected the Secretary of the Treasury into every savings bank as a partner; and savings bank managements may be assured that he will be anything but a silent partner. Having partially recovered from the initial impact of the change to a taxable status, savings institutions are giving considerable thought to conditioning their operations to the new way of life. They are concerned with such matters as obtaining clarification of doubtful points in the law, the taking of steps to minimize tax liability through careful planning, and the setting up of arrangements to do the preparatory work involved in obtaining data for the first income tax return. It is hoped that this article will provide some help in approaching immediate problems confronting the banks today. The doubtful points of law will be mentioned here, but, inasmuch as this article is intended to stress the practical side of preparing for the application of the new law, a minimum of time will be spent in weighing the merits of the positions taken. In the interests of simplicity, references will be confined to savings banks even though the amendments in question also cover cooperative banks and domestic building and loan associations.

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This article was published originally in the December, 1951, issue of the Savings Bank Journal. As presented here, it has been revised to reflect informal rulings issued by the Commissioner to the Savings Bank Association and the Regulations under Supplement U of the Code which were not available previously. Certain material not of current interest has been deleted.

Selection of Reporting Period

A taxpayer making its first return is permitted to elect a calendar year or a fiscal year (a year ending on the last day of any month other than December) as a basis for reporting. The Commissioner probably will rule that the election extends only to new businesses and that savings banks must report on the basis of the annual accounting period heretofore used in closing the books. If there is doubt about the annual accounting period, a review should be made of such matters as the period used in reporting to the United States Treasury Department on Form 990, provisions in the bank's charter and by-laws concerning fiscal periods, and the periods covered by reports to state and federal supervisory authorities and to depositors. Once a particu-

lar reporting period has been established, the approval of the Commissioner of Internal Revenue is necessary to effect a change.

The new tax is applicable to taxable years beginning after December 31, 1951. The Commissioner has ruled that savings banks on a fiscal year basis will not be required to file returns for the short period beginning with January 1, 1952, and ending with the last day of the month which precedes the start of the fiscal year. Thus, a bank which reports on a fiscal year ending March 31st will escape tax on its net income for the first three months of 1952 and its first tax return will cover the twelve months ending March 31, 1953. A Form 990 should be filed with the Commissioner for the year ended March 31, 1952.

Tax Rate Structure

For 1952, the normal tax rate will be 30 per cent and the surtax rate, which only applies to net income over $25,000, will be 22 per cent, so that the combined rate for net income over $25,000 will be 52 per cent. The capital gain rate applicable only to net long term capital gains will be 26 per cent. The excess profits tax does not apply to savings banks. Careful planning may bear fruit in effecting savings made possible by the variations in the rate structure. For instance, it is preferable to have a level income within the $25,000 range than to have a fluctuating income which results in little or no tax in one year, and taxation of some income at 52 per cent in the next year. This factor should be borne in mind when considering such matters as determining the amount of bad debt deduction to be claimed, declaring extra dividends, etc.

Cash or Accrual Basis

Just as in the case of the reporting period, a binding election as to accounting basis probably has been made heretofore by most banks and any change will require the approval of the Commissioner. As a general rule, use of a cash basis tends to defer net income into later years and hence postpones the payment of taxes. Whether or not this postponement is beneficial depends to some extent on the future course of tax rates. The accrual basis is a sounder method of accounting and is generally preferable for tax purposes because it tends to match expenses with the income to which such expenses relate. One problem which will prove vexing for savings banks on an accrual basis will be whether or not to accrue interest for a mortgagor in default. The only general rule to be followed is that each situation must be studied to determine the collectibility of the interest. Certainly, as soon as foreclosure or a similar remedy appears imminent, accrual of interest income should be discontinued.

Books of Account

The gap between savings bank and income tax accounting is substantial because income tax accounting is based primarily upon cost as variously defined in the Internal Revenue Code, whereas accepted principles of savings bank accounting call for rapid write-downs from cost to or below market value. It will prove disagreeable and arduous for savings bank personnel to adjust their thinking back and forth between traditional savings bank viewpoints and legalistic tax concepts. The examining revenue agent, who henceforth will be a regular visitor, has no authority to permit a bank to follow practices which are at variance with the tax law. This does not mean, however, that each account in the regular books must be converted to a tax basis. In the interests of simplicity it is advisable to conform accounting policies to tax concepts wherever possible, but it is seldom mandatory to do so. This means that in most banks separate tax records will be maintained for such assets as banking houses, furniture and fixtures, securities, mortgages, prepaid expenses, and for the depreciation and amortization of same. It is not unusual

for the book net income of commercial companies to differ from taxable income, but it seems safe to predict that the degree of difference will be greater for savings banks than for any other category of taxpayers.

Cost Bases of Assets

The extent to which the adjustments prescribed by Section 113 of the Code apply to assets owned by savings banks as of December 31, 1951, is doubtful at this time. The conversion of an entire class of organizations from an exempt to a taxable status has had but one precedent since March 1, 1913, and that occurred in 1950 when Supplement U was enacted into law making "feeder" organizations owned by tax exempt institutions subject to tax. In GCM 10857 (issued in 1932) the Treasury Department ruled that a previously exempt institution need not reduce the cost basis of real estate for depreciation sustained up to the date of the change in tax status. The theory used to support this conclusion was that such depreciation was neither "allowed" nor "allowable" during the period of exemption. Section 113(b)(1) of the Code provides that the cost basis of depreciable assets must be adjusted for depreciation allowed, but not less than the amount allowable. The proposed regulations relating to Supplement U are in conflict with GCM 10857 and seem to clash with the language of Section 113(b)(1) of the Code in that the "feeder" corporation would be required to adjust the cost basis of depreciable assets ". . . for depreciation for all prior taxable years whether or not the organization was exempt from tax for any of such years" (Reg. 111, Section 29.423-3; see also instruction 19, Form 990-T). Presumably, but not certainly, the regulations for savings banks will follow the Supplement U regulations in this respect. It is a strange commentary on the complexity of our tax laws that the end result of the inevitable litigation on this issue will be favorable to some banks and adverse to others. If the unadjusted cost basis were used the depreciation deduction would be higher, but this benefit might be more than offset by the disadvantage incident to an increase in surplus for purposes of the special bad debt deduction. For instance, a banking house erected in 1922 at a cost of $300,000 would be considered under GCM 10857 to have a cost basis of $300,000 for calculation of depreciation after January 1, 1952, and, assuming a fifty-year life expectancy, such property would be depreciated at the rate of $15,000 a year for the remaining twenty years. On the other hand, the adjusted cost basis at January 1, 1952, would be $120,000 and depreciation for subsequent years would be limited to $6,000 per year. The addition to surplus at January 1, 1952, for the bad debt computation, assuming that the asset had been written down to $100,000 on the books, would be $200,000 and $20,000, respectively.

The same dubious situation applies to premiums on non-taxable and partially taxable bonds (although not to fully taxable bonds), to acquisition costs of mortgages, and other costs subject to amortization. There is no action to be taken by a bank for the present which would be helpful to it other than to start assembling the information needed to establish cost bases. Otherwise, the next move on adjustments to cost bases rests with the Commissioner (the proposed regulations are expected to be issued in the summer of 1952).

Capital Gains and Losses

It is a fundamental principle of tax law that a change in ownership is a taxable event except for those types of transactions which have been made tax free by specific legislation. Careful timing in the disposition of capital type assets in taxable transactions can produce substantial tax savings, or what may be more important, can avoid substantial tax leakages. The assets under discussion fall into three classes: (1)

bonds, notes, etc., (2) mortgages and stocks, and (3) banking houses and furniture and fixtures. Rather than attempt to define the term capital asset, the approach will be to classify and discuss the capital-type assets characteristic of savings banks.

Section 117(i) of the Code, in a special rule which applies only to banks, allows a net loss from the sale of bonds, debentures, notes, and certificates of indebtedness issued by any corporation, the Government, or any political subdivision with interest coupons or in registered form to be deducted in full from ordinary income, i.e., as an ordinary loss and not a capital loss. A loss from partial or complete worthlessness of bonds, etc., is also deductible in full (as a bad debt). The Commissioner recognizes a conclusive presumption of worthlessness in whole or in part when a bank is required to make a charge-off of a bond, etc., by the order of a regulatory authority. Lacking such an order, the bank will have to prove its case for a charge-off by presenting the facts on which it relied.

Mortgages and stocks present a more complex and less favorable picture. Sales of mortgages and stocks held for over six months may result in a net long term capital gain or loss. A net profit on the sales of these investments held for less than six months, although termed a short term capital gain, is taxed as ordinary income, and a net loss sustained on sales within that period is a short term capital loss. Capital losses may be used to offset capital gains but a net capital loss is not deductible from ordinary income. If unused in the year sustained, a net capital loss, whether short term or long term, may be carried over during the five succeeding years to be applied against capital gains realized in those years.

The rules for mortgage foreclosures are somewhat bewildering. Upon foreclosure, if the bank does not buy in the property, any loss sustained will constitute a bad debt. Such loss would be measured by the difference between the cost basis of the mortgage to the bank and the amount received from the buyer; this assumes that the balance is uncollectible from the mortgagor. However, if as happens in most instances, the bank buys in the property for a price less than the principal of the mortgage, it may have a bad debt and capital gain, or a bad debt and a capital loss. The regulations at Section 23(k)(3) state that "the fair market value of the property shall be presumed to be the amount for which it was bid in by the taxpayer in the absence of clear and convincing proof to the contrary." The capital gain or loss feature arises because of the rule that the difference between bid price and fair market value is capital gain or loss. To take a simple example, let us assume that the cost basis and unpaid balance of a mortgage are both $10,000, that the bid price by the mortgagee-bank is $5,000, and the fair market value is clearly established at $6,000. If the remaining $5,000 of the mortgage is uncollectible, a bad debt will be realized in that amount. In addition, a capital gain of $1,000 will be considered to have been realized because the value of the property exceeded the bid price by that figure. From these brief comments it can be seen readily that mortgage departments and attorneys will have to be alert to the tax significance of foreclosures. One obvious precept is that the bid price should be no higher than is necessary to acquire the foreclosed property.

By reason of Section 117(j) of the Code, net long term losses from the sale or involuntary conversion (casualties, condemnation, etc.), of depreciable or real property used in the trade or business are deductible in full from ordinary income whereas a net gain is treated as a capital gain. It is believed that real property acquired by a savings bank through foreclosure and held over six months will qualify for the advantages obtainable under 117(j).

In general, it pays to match capital gains against capital losses in the same year without allowing the unused capital loss carry-over provision to operate. In changing the securities portfolio, care should be taken not to run afoul of the wash sale provision whereby losses are disallowed if substantially identical securities are purchased thirty days before or after the sale. The weight of authority seems to be that the wash sale provision would not apply to savings banks prior to January 1, 1952. In general, the wash sale provision merely acts to postpone the taking of a tax deduction because the amount of loss denied by reason of the repurchase is added to the cost of the shares acquired within the sixty-one day period. The wash sale provision does not apply to gains so that reinvestment may be made shortly after the sale. Where less than all of a particular issue of bonds or stocks is sold, the cost of what is sold should be determined by specific identification of the certificates actually delivered. If such identification is not possible, the first-in, first-out method should be used, i.e., the securities purchased first will be deemed to have been sold first. Use of average cost is unacceptable unless no other means of identification is possible.

The following illustrates the interplay of the various types of capital-type gain and loss transactions:

	Deductible In Full	*Capital Loss*	*Bad Debt*
LOSSES—LONG TERM			
*Net loss on sale of bonds	x		
Loss on sale of mortgage		x	
Loss on sale of stock		x	
Write-down of mortgage			x
Uncollectible principal of mortgage on foreclosure			x
Excess of bid price on foreclosure over fair market value of property		x	
Net loss on sale of furniture	x		
Net loss on sale of realty acquired by foreclosure	x		

*Fully deductible whether or not held for six months.

	Capital Gains
GAINS—LONG TERM	
Net gains on sale of bonds	x
Net gains on sale of mortgages and stock	x
Excess of market value of foreclosed realty over bid price	x
Net gain on sale of furniture	x
Net gain on sale of realty acquired by foreclosure	x

Municipal Bonds

Interest from state and municipal bonds is exempt from the Federal income tax because of a limitation on the Federal taxing power set forth in the Constitution. This feature has made municipals so attractive that the net interest yield is quite low. Assuming that there is no substantial difference in security of principal, it will be profitable for banks with taxable net income in excess of $25,000 to invest in municipals if the net yield after amortizing premium is greater than 48 per cent of the interest on the bonds with which the municipals are being compared.

Dividend Income

As a partial relief from double taxation, corporate shareholders in domestic and some foreign corporations are allowed a credit against normal and surtax net income equal to 85 per cent of dividends received. This credit is limited to 85 per cent of adjusted net income. The effective tax rate on dividend income for a bank in the 52 per cent bracket would be 7.8 per cent, or a difference in rate of 44.2 per cent. The credit for dividends received on certain types of preferred stock of public utility companies is limited to 62 per cent for 1952. This lower credit relates

only to dividends on the preferred stock of those public utilities which benefit from the credit provided in Section 26(b) of the Code. Where state law permits, bank managements should consider investing in equities in order to curtail the tax burden. One disadvantage to the ownership of stocks is that, in contrast with bonds and notes, any loss sustained on sale is subject to the capital loss limitations.

Amortization of Bond Premiums

Corporations are required to amortize premiums on tax exempt and partially tax exempt bonds and to offset such amortization against the interest to which it applies. All taxpayers have a right of election to deduct amortization of premiums on taxable bonds. Amortization so taken must be applied in reduction of the cost bases of the bonds for purposes of computing gain or loss on disposal. The election for taxable bonds is made by claiming the deduction for the first taxable year in which it is desired to do so. Once made, the election is binding for all bonds then owned or thereafter acquired until the Commissioner grants permission to revoke the election. For bonds owned by a savings bank at January 1, 1952 and those acquired prior to making the election, the rate of amortization must take into account the entire holding period. Thus, for a fully taxable ten-year bond which cost $110 when purchased in 1948, the premium would be amortized at the rate of $1 per year from 1952 to 1957, and, at redemption in 1957, the cost basis would be $104. If the theory underlying GCM 10857, supra, is not applicable to savings banks, amortization of premiums on tax exempt and partially taxable bonds might be considered mandatory beginning with January 1, 1942 and the cost bases of such bonds would be reduced accordingly. Savings banks should give serious consideration to the election to amortize taxable bonds because (1) such amortization will tend to reduce surplus year by year for purposes of the 12 per cent bad debt factor, and (2), if the bonds should be sold at a gain, the net profit, if any, would be taxed at the capital gain rate whereas the amortization of premiums would have been deducted from ordinary income at full tax rates.

Bad Debt Reserves

Section 23(k)(1) of the Code, as recently amended, allows savings banks a special provision for bad debts. Presumably, in the case of savings banks this reserve will apply solely to mortgages. The deduction in any year may not exceed the amount by which 12 per cent of deposits at the end of the year exceeds the sum of surplus, undivided profits, and reserves at the beginning of the year. A further limitation is that it may not exceed the net income for the year. This latter limitation prevents the building up of an operating loss carry-over. The language of the amendment to Section 23(k)(1) indicates that the taxpayer has discretion to claim or not to claim the deduction, or to claim less than the maximum allowable.

Under Section 23(k)(1) the Commissioner has had broad discretionary powers to allow a reasonable addition to a reserve for bad debts. The first sentence of the amendment to Section 23(k)(1), (Section 313(e) of the 1951 Act), limits that discretion to some extent, for savings banks only, by providing that "the reasonable addition to a reserve for bad debts shall be determined with due regard to the amount of the taxpayer's surplus or bad debt reserves existing at the close of December 31, 1951". The second sentence of Section 313(e) covers the special 12 per cent bad debt provision. What is the status of a savings bank which does not qualify for this special provision and hence is affected by the Congressional injunction set forth in the first sentence of Section 313(e)? The Commissioner, in determining a reasonable addition to the reserve with due regard to surplus or reserves at

December 31, 1951, may adapt to savings banks the twenty-year moving average formula allowed to commercial banks, may use a twenty-five year moving average, or develop an entirely new approach. Although any taxpayer may elect to employ the charge-off method of accounting for bad debts, it generally would be desirable tax-wise for savings banks to use the reserve method.

As indicated heretofore, ascertainment of the sum total of surplus and reserves for the purpose of evaluating a bank's position for the 12 per cent limitation is fraught with uncertainty. Judging from the Supplement U regulations, there is a strong probability that the Commissioner will rule in favor of an adjusted cost basis for depreciable and other assets. It is recommended that any bank which needs an estimate of its position as an operating tool prepare two tax balance sheets as of December 31, 1951, for the purpose of estimating its position with respect to the 12 per cent bad debt factor. One of these balance sheets should be on a conservative (for this purpose) basis, i.e. assets should not be adjusted for depreciation and amortization; the other should reflect the accumulated depreciation and other valuation adjustments. Banks for which the ascertainment of the bad debt reserve position is not a pressing problem should compile the necessary cost data as time permits because such information will be required regardless of the outcome of the conflict of theories. The following may prove of some help in preparing these balance sheets:

Banking house—If acquired after March 1, 1913, use cost of land and building plus additions and improvements. If owned at March 1, 1913, use net depreciated cost at that date or market value at that date, whichever is higher, plus additions and improvements.

Furniture and fixtures—Use cost of assets now owned.

Mortgages—Mortgages should be reinstated at cost including commissions and other acquisition costs.

Securities—All investments should appear at cost.

Deferred charges—Prepaid expenses such as insurance premiums covering unexpired periods, stationery, printing on hand, etc., should be set up as assets.

Pension plans—Amounts which are recoverable under revocable plans should be considered as still the property of the bank.

Liabilities—Liabilities which are overstated on the books should be placed on a realistic basis.

The usual adjustments required to reduce the cost bases of these assets for the second balance sheet consist of depreciation on banking house and furniture and fixtures, amortization of the acquisition cost of mortgages, and amortization of premiums on tax exempt and partially tax exempt securities. The determination of a formula for amortizing mortgage acquisition costs is a vexing problem. For this purpose, an arbitrary method based upon knowledge of the nature of the bank's portfolio would seem sufficient.

After these figures have been determined or approximated, the net increase in asset values and all reserves against mortgages and securities, whether allocated or general, should be added to the surplus. To the extent that the aggregate of surplus and reserves at January 1, 1952, as adjusted, is lower than 12 per cent of estimated deposits at the end of the year, the bank should be entitled to deduct a provision for bad debts for the year 1952.

In analyzing the operation of the 12 per cent factor, it is important to understand that the bad debt provision of one year will be added to the reserves at the end of that year for purposes of computing the bad debt provision for the following year. Since the additions to reserves will tend ultimately to bring the ratio of surplus and reserves to 12 per cent of deposits, the incentive to increase deposits will be stepped up considerably. For a bank which benefits from the 12 per cent factor, if the

addition to bad debt reserve in one year exceeds 12 per cent of the increase in deposits of the next year, the bank is losing ground in retaining its tax free position. For a bank which is above the 12 per cent level, any increase in deposits which, when multiplied by 12 per cent, yields a result higher than the net accretion to surplus for the preceding year tends to move that bank in the right direction. No consideration has been given in the above to charges against the reserve by reason of realized losses and write-downs required by state and federal authorities. These charge-offs will decrease the reserves and hence will tend to make available further bad debt provisions.

Dividends Paid to Depositors

Section 23(r) of the Code has been amended to permit mutual savings banks, cooperative banks, and domestic building and loan associations to deduct from gross income "amounts paid to, or credited to the accounts of depositors or holders of accounts as dividends on their deposits or withdrawable accounts, if such amounts paid or credited are withdrawable on demand subject only to customary notice of intention to withdraw". The scope of this section is not as clear as it may appear to be at a first reading because the term "dividend" as used by the savings banks is somewhat ambiguous from a tax standpoint. For banks on a cash basis of accounting the section needs no extended comment; however, accrual basis banks should be alert to the need for clarification. Treasury ruling IT 1461 observes that depositors in New York mutual savings banks occupy the status of creditors, and from this premise rules that dividends on deposits should be treated as interest for tax purposes. IT 1461 may be a weak foundation on which to build a potentially important tax case both because it is obsolete in our present tax structure and because it relates to the taxability and not to the deductibility of dividends. Congress seemingly reasoned that Code Section 23(b) which pertains to the deductibility of interest on indebtedness, is not broad enough to allow the deduction of dividends paid by those institutions whose depositors would not qualify as creditors, and hence felt obliged to insert Section 23(r). Does Section 23(r), in effect, modify Sections 23(b) and 43 of the Code, and thus place all savings institutions on a cash basis for deducting dividends, or does it merely make available a deduction for dividends to those banks which otherwise would obtain no such deduction? On a straight accural basis, dividends would be deductible on the day the bank incurs a legal liability to make the payment, and the date of payment or credit would be irrelevant. Until this point is cleared up, banks should try to bring their dividend and bookkeeping practices clearly within the requirements of both approaches in order to ensure that deductions for dividends will be allowed in the year planned.

Many savings banks will pay higher dividends beginning with 1952. A bank with $100,000,000 in deposits which increases dividends by $250,000 or ¼ per cent, would reduce its income tax by $130,000, making the net cost of the dividend $120,000. Thinking in terms of the 12 per cent bad debt factor this dividend would be advisable because (1) it would reduce surplus and reserves in relation to the requisite 12 per cent of deposits (2) it should increase deposits because experience indicates that depositors leave a high percentage of dividends in their accounts, and (3) it would tend to attract more deposits.

Pension Plans

Sections 23(p) and 165 of the Code impose rigid restrictions on the deductibility of payments under pension plans. Banks, which in the past have subscribed to an already qualified plan such as the Savings Banks Retirement Fund of New York will be entitled to deduct regular contributions in determining taxable income. Apparently the past service costs applicable to 1952

and later years under qualified plans established within ten years prior to the effective date of the new law will be deductible in 1952 and later years over the remaining years of the ten year span. Banks with plans which have not qualified should consult counsel so that they may amend the plans to meet the requirements of the tax law. Banks which have no plan and expect to be in the 52 per cent tax bracket should give serious consideration to inaugurating a plan in order to take advantage of the deduction allowed by Section 23(p).

Taxation of Life Insurance Departments

A mutual savings bank which operates a separate life insurance department to the extent of issuing life insurance contracts and segregates its accounts so as to reflect results of that activity will be taxable on its income from that department in the same manner as though it were a life insurance company. As life insurance companies are taxed at considerably lower rates than other corporations, this provision is beneficial if the life insurance department operates at a profit. On the other hand, where the department operates at a loss, it will prove detrimental in that it will tend to increase the taxable net income from banking operations.

Deduction for Repayment of Certain Loans

A special deduction is allowed for the repayment of loans made prior to September 1, 1951, by a governmental agency or instrumentality or by a mutual fund established under the laws of a state. This will only be helpful to a limited number of banks.

If this article should provide some help in developing an approach to your immediate problems, it will have served its purpose. The enactment of the law is much too recent to permit definitive comments on any but the more obvious topics. A body of law and practice will emerge in time which will make many of the present problems seem simple and academic. In the meanwhile, we shall have to struggle along with the inadequate information now at hand.

AN ADIRONDACK VIEW

Deducts. Do you deduct in income tax returns the cost of fishing trips—yours and your clients? Here is an up-state New Yorker who does, according to FORTUNE—Lawrence K. Witherill, of Cazenovia—near Syracuse. By the way, the Syracuse Chapter has a pretty lively bunch of swains, they are full of bright ideas, some good and some—well, let's skip it. Mr. Witherill is president of the Gladding Company. His fishing trips are a business expense—what a business! He is testing fish lines! His company makes them.

Down in Rhode Island a company deducted, as expense, the cost of a radio. This was years ago when decent radios cost a sizeable amount. The company had to have it in order to get corect time, daily. They had just installed a new electric clock system and it was an "ordinary and necessary expense" in order to set the master clock.

For information as to other "deducts" you should attend the 19th annual New York CPA Conference at Saranac Inn, June 15 to 18—and deduct the expense.

LEONARD HOUGHTON
Adirondack "Chapter."

Do Gifts of Farm Products and of Mercantile Inventory Result in Income to the Donor?

By EDWARD T. ROEHNER, C.P.A.

This paper discusses and evaluates certain divergent viewpoints recently expressed in legal periodicals and proposes another solution to the problem.

Introduction

A disagreement in print between two of the outstanding members of the tax bar shows the absolute necessity of a knowledge of basic accounting principles to the tax man. One of them supports his position by confusing the cost of production (asset) with the expense of "maintaining or protecting" the finished product (deduction); the other supports his position by asserting that a manufacturing corporation that makes a gift of inventory increases its cost of sales.

Mr. Robert N. Miller, formerly Chief Counsel to the Bureau, disagrees with two Treasury rulings which state that by making a gift to charity or to a son of farm products raised primarily for sale, a cash basis farmer realizes income at the time of the gift in the amount of the fair market value of the gift. He believes that the farmer does not realize any income by the gift, even though he deducts as an expense the cost of producing the gift.

EDWARD T. ROEHNER, C.P.A. and attorney, is a member of our Society, of the American Institute of Accountants, and of the Association of the Bar of the City of New York. He was formerly Associate Editor of the New York Law Journal and later Technical Head of the Federal Tax Department of Research Institute of America. Mr. Roehner is now engaged in the practice of law in New York City.

Dean Erwin N. Griswold, of Harvard Law School, agrees with the Treasury, and would extend the rulings to manufacturing corporations. He declares that at present manufacturing corporations get a double deduction when they make a gift to charity: one deduction for the reduction in the inventory, the other deduction for the value of the gift to charity.

I disagree with both Mr. Miller and Dean Griswold. Unlike Mr. Miller I believe that the cash basis farmer realizes income when he makes the gift, and unlike Dean Griswold I believe that the income realized is the amount deducted to produce the gift. Dean Griswold is of course in error in his statement that a manufacturing corporation gets a double deduction for a gift to charity; although one tax service has followed him.[1]

I believe that the courts will hold, independent of regulations, if the point is presented to them, that a cash basis farmer must include in income the cost of production of a gift; and that, even if they do not, they will uphold a regulation which so provides.

Mr. Miller fears that the Treasury, if the courts uphold it, will seek to extend the principle of the rulings to gifts of appreciated property. Dean Griswold has therefore drafted a statute to exempt from tax the appreciation in property donated to charity and to eliminate the double deduction in the gift of inventory. The statute, however, is defective, since it denies a taxpayer any deduction for a gift to charity if

[1] See final paragraph under rubric "The Manufacturer."

the property has a zero basis, and it also denies a manufacturer even a single deduction for a gift to charity of inventory.

The Farmer

A cash basis taxpayer does not realize income until he receives cash or its equivalent, either actually or constructively.[1a] If inventories are necessary to determine the net income of a taxpayer he may not use the cash basis, but must use the accrual basis.[2] The farmer is an exception to the rule that if inventories are necessary to determine the net income of a taxpayer the accrual basis must be used. A farmer is permitted by the Treasury to use the cash basis if he wishes.[3] If he does, he deducts the costs of production as expenses,[4] and does not use inventories; instead, he reports the farm products, cattle or wheat, for example, when he receives cash or its equivalent for them.[5]

Since the farmer deducts the costs of production as expenses, farm products raised primarily for sale have no basis, and the entire fair market value of farm products donated to charity would, if sold, be taxable at ordinary income rates. If a farmer by making a gift of farm products may exclude from income all of the amount he would have received if he had sold the farm products, and also get a deduction from income for the fair market value of the farm products donated, a beautiful way to tax avoidance is open.[6] The possibility of this exaggerated tax avoidance does not exist if the gift to charity is in appreciated securities.[7]

Perhaps because of attempts at tax avoidance by cash basis farmers through gifts to charity of commodities raised primarily for sale,[8] the Treasury has ruled that, if a cash basis farmer makes a gift to charity for relief purposes of wheat raised primarily for sale,

[1a] 2 Mertens, Law of Federal Income Taxation §11.01.

[2] Reg. 111, §29.22(c)-1.

[3] Reg. 111, §29.22(c)-6.

[4] Reg. 111, §29.23(a)-11.

[5] Reg. 111, §29.22(a)-7.

[6] As an illustration of the tax avoidance possible, let us assume, using 1951 rates, that a cash basis farmer who is single has wheat which if all of it were sold would make his surtax net income for the year exactly $20,000. His tax would then be $7,396, and he would have $12,604 left after tax. By giving $2,000 of the wheat to charity, he has surtax net income of $16,000, and he pays a tax of $5,296, leaving him $12,704 after tax. He therefore has $100 more left after tax than if he had not made the gift to charity. If the sale of the wheat would increase his surtax net income to $60,000, he would pay a tax of $34,696, leaving him $25,304 after tax. If instead, he gives $7,500 of wheat to charity, his surtax net income would be $45,000, and his tax would be $23,546, leaving him $28,954 after tax, or $3,650 more than if he had not made the gift to charity. Besides the farmers have the personal pleasure of the gift to charity and the community prestige attached to a sizable charitable gift.

[7] Let us assume a taxpayer with a surtax net income of $20,000. He has securities with a basis of $1,000 which he sells for $3,000. He pays a capital gains tax of 25%, or $500, leaving him a total after tax of $15,104. If he gives the securities to charity, his surtax net income is $17,000, on which he pays tax of $5,806, and has $14,194 left after tax, or $910 less after tax than if he had not made the gift to charity. If a taxpayer has surtax net income of $60,000, his tax is $34,696, and he has $25,304 left after tax. Let us assume that he has securities with a fair market value of $9,000 and a basis of $3,000. If he sells them he pays a capital gains tax of $1,500, and has left after tax a total of $32,804. If he gives the securities to charity, he has surtax net income of $51,000, on which he pays a tax of $27,946, and has $32,054 left after tax, or $750 less than if he had not made the gift to charity.

[8] Miller, infra note 12, at p. 11: "Apparently the Income Tax Unit would not have changed its mind and issued the recent farm rulings but for certain instances in which farmers made charitable gifts of large quantities of farm products. As regards charitable and similar gifts made in property, I.R.C. §23(o) has for many years been construed as allowing a deduction in the amount of the fair market value of the property at the time it is given, rather than the amount of the taxpayer's basis for the property. Under this construction, a farmer having substantial income from other sources may get a very considerable tax advantage by a gift of farm products having a zero basis, in addition to the advantages from deductions for raising the products."

he must include in gross income at the time he makes the gift the fair market value of the wheat.[9] Later in the same year it issued a somewhat similar ruling. A farmer who was a livestock raiser made a bona fide gift to a son of cattle he had raised primarily for sale. The Treasury here too ruled that the farmer must include in income the fair market value of the cattle at the time of the gift.[10] The Treasury bottomed both rulings on the *Horst* case, which dealt with the realization of income by cash basis taxpayers.[11] Although the rulings were not expressly restricted to cash method taxpayers, it is clear that the rulings were intended to apply only to them. For example, the second ruling held that the farmer who made a gift of cattle to his son had a zero basis, but he could have a zero basis only if he used the cash method.

Neither Mr. Miller nor Dean Griswold distinguishes between cash method and accrual method farmers. Their articles read as though the rulings applied to all farmers, and as though all farmers were on the cash basis.

Mr. Miller disagrees with the rulings, and maintains that a taxpayer does not realize income by giving tangible property away; that therefore the *Horst* case does not apply.[12] In the *Horst* case, the taxpayer, who was on the cash basis, owned some bonds and gave the coupons maturing during the year to his son as a gift. The Supreme Court held that realization is the taxable event, and that realization is not deemed to occur until the income is paid, but that procurement of the payment of income earned to another is payment to the donor when received by the person to whom the gift of income was made.[13] As owner of the bonds, the taxpayer was entitled to the income which he had assigned. Mr. Miller points out that in the *Horst* case the father retained ownership of the bonds, and that the son's possession of a coupon was no more than evidence of his authority to collect the interest and to give a valid receipt for it. He further points out that in the farm products situation, on the other hand, the farmer gave away full ownership of tangible property; the farmer did not direct that income to which he was entitled be paid to another.[14]

Dean Griswold disagrees with Mr. Miller.[16] He says that the farmer realizes income when the crop is severed

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9 I. T. 3910, 1948-1 Cum. Bull. 15.

10 I. T. 3932, 1948-2 Cum. Bull. 7. Dean Griswold tells us, infra note 16, at p. 84: "The contrary result has, however, been reached by the Tax Court. W. G. Farrier's Estate, 15 T. C. 277 (1950)." It is significant that the Tax Court said at the end of its opinion, which was reviewed by the Court: "For all that the evidence shows, or the respondent claims, there was no contract for sale of the cattle or thought of their sale at the time the gift was made. There was, in the gift, no element of an assignment of earned income." One district court recently held, without opinion, that a cash basis farmer who makes a gift of wheat to a charity for relief purposes (no deduction being taken for the charitable contribution, which was much in excess of 15% of the adjusted gross income) does not include the fair market value of the wheat as income. (David C. White v. Brodrick, Collector, 1952 P-H Par. 72,347, 52-1 USTC Par. 9238.)

11 Helvering v. Horst, 311 U. S. 112 (1940).

12 Robert N. Miller, Gifts of Income and Property: What the *Horst* Case Decides, 5 Tax L. Rev. 1 (November, 1949). Mr. Miller points out that the question was earlier discussed in a Note, Gratuitous Disposition of Property as Realization of Income, 62 Harv. L. Rev. 1181 (May, 1949).

13 Miller, supra note 12, at p. 5: "This, strangely enough, is the case which the Treasury claims established the 'rule' that realization may occur *at the time the gift is made*—which may or may not be in the same year as the event by which the donee cashes in."

14 Miller, supra note 12, at p. 6.

16 Erwin N. Griswold, Charitable Gifts of Income and the Internal Revenue Code, 65 Harv. L. Rev. 84 (November, 1951).

from the land.[17] If Dean Griswold contends that, as to cash basis taxpayers, severance from the land results in income, the *Horst* case is squarely against him. It holds that a cash basis taxpayer does not realize income except upon receipt of cash or its equivalent. If he is contending that it is "reasonably clear" constitutionally that the farmer realizes income when he harvests his crop, he is attempting to prove something that accrual basis farmers do not dispute.

Dean Griswold continues that it has long been the law that a farmer does not report as income the value of a crop until he has sold the crop,[18] but the regulation which he cites in support of that statement clearly reads that an accrual basis farmer includes in income the inventory value of the crop.[19]

Dean Griswold goes on to maintain that, if the farmer "frustrates the objective of the concession" that he report income only when he receives cash, it seems entirely appropriate to include in his return the value of the wheat given away.[20]

For the reasons advanced by Mr. Miller which are stated earlier in this article, I do not believe that the *Horst* case applies. I do believe that the courts will hold, when the point is raised, that a farmer should be treated the same as any other business man who makes a gift of products he produces primarily for sale. Since a business man who makes a gift out of

[17] Griswold, supra note 16, at p. 86: "Mr. Robert N. Miller, who may well be regarded as the dean of the tax bar, has written an interesting article in which he finds the rulings quite unsound. Mr. Miller takes the position that a taxpayer cannot 'realize' income merely by giving property away. There was a time when our tax law was much concerned with problems of realization. It now would appear to some that perhaps this approach was unduly conceptualistic, and that the tax law has made progress in freeing itself somewhat from the rigidity of the older test.

"However, even accepting Mr. Miller on his own ground, it does not seem entirely clear that the Treasury was wrong, in the wheat ruling at least. Has there not been full and adequate realization there. Does not the farmer *realize* income at least when he cuts the wheat? One of the tests of realization was that of 'severance.' It would seem reasonably clear that this test is met, in the case of a crop, when the crop is severed from the land by being cut or picked. After the crop is cut, the farmer retains all of his capital—the land. The wheat, or other crop, then in his possession would seem to be the clearest sort of income, and to have been fully realized when it is harvested."

[18] Griswold, supra note 16, at p. 87: "It has long been the law that a farmer does not report as income the value of a crop until he has sold that crop; and he then reports the amount which he receives on the sale. This is clearly a rule of convenience, and a very desirable rule. But it does not mean that the income is not 'realized' until the time of sale. It merely means that the taxability of income already realized, at the time of severance, is postponed for reasons of convenience—the taxpayer's convenience—until the subsequent time of sale which puts the farmer in cash."

[19] Reg. 111, §29.22(a)-7.

[20] Griswold, supra note 16, at p. 87: "As indicated, this rule is clearly devised for the farmer's convenience. It is a concession to him, and a desirable and justifiable concession. But if the farmer frustrates the objective of the concession, by giving away the income already realized, it seems entirely appropriate to require the farmer to include in his return the amount of the income which he has already realized, even though he has not converted it into cash. It is of course clear that income may be realized in a medium other than cash. A lawyer paid his fee in wheat could not plausibly contend that he has not realized income. Is there any reason why a farmer who derives his income in wheat—and many do—should not be regarded equally as having *realized* his income when he receives his wheat, separated from his capital? The fact that he is not ordinarily taxed on it until he sells it does not mean that he has not realized the income when the matured and harvested crop comes into his possession."

I find rather puzzling Dean Griswold's argument that, since a lawyer paid his fee in wheat realizes income, a farmer who severs his wheat from the land realizes income. He is, of course, talking of a cash basis lawyer, since an accrual basis lawyer would report income when the right to receive accrued, not when he received payment. I could see the analogy if Dean Griswold argued that a farmer who receives payment in another commodity for his wheat realizes income at the time of receipt. Cf. Reg. 111, §29.22(a)-7 Gross Income of Farmers: "If farm produce is exchanged for merchandise, groceries, or the like, the market value of the article received in exchange is to be included in gross income."

inventory returns as income the cost of production of the items donated (by crediting, and thus reducing, Cost of Goods Sold), I believe that the courts will hold that a farmer who has taken a deduction for income tax purposes of the cost of production of farm products raised primarily for sale must return the amount of the deduction to income when he puts it out of his power, by giving the farm products away, to receive the amount he has deducted.

Mertens says that when amounts which have been allowed as deductions in prior years are subsequently recovered, tax justice requires that adjustment be made in reporting income for the year in which the change occurs.[21] The same sort of tax justice requires that a cash basis farmer who has taken the cost of production as a deduction restore the amount of the deduction to income if he gives the farm products away.

Mr. Miller believes that the farmer is entitled to deduct the cost of producing the commodity, and in addition to get a charitable deduction for the fair market value of farm products contributed to charity.[22] He does not see how the statement in the rulings that the cost of producing the commodity has been deducted by the farmer helps the Treasury's position, since the expense of "maintaining and protecting" property does not affect the profit realized on the sale or exchange of property, which depends upon the excess of value received over basis.[23] But Mr. Miller and the Treasury are discussing two different things. The Treasury is discussing the cost of producing the commodity, Mr. Miller is discussing the expense of "maintaining or protecting" the commodity after it has been produced. For example, under established accounting principles and the regulations, an automobile manufacturer includes as part of the cost of production the expense of "maintaining and protecting" an automobile in the process of manufacture.[24] Once the automobile has been completed, "maintaining and protecting" the automobile is a deductible expense and does not affect the cost of production, which is the basis for determining gain or loss on the sale of the automobile.

The Manufacturer

Dean Griswold has extended the principle of the two Treasury rulings to a manufacturing corporation that makes a gift of inventory to charity. He argues that, absent such a principle, the manufacturing corporation will get a double deduction: one deduction as a business expense for the cost of producing the gift, and another deduction

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[21] 1 Mertens, Law of Federal Income Taxation §5.15: "Our income tax system has been built around the theory that income tax liability must be determined for annual periods on the basis of facts as they existed in each period. The courts on numerous occasions, and particularly in recent years, have indicated that when under this system items which have been allowed as deductions in prior years are subsequently recovered, tax justice requires that adjustment be made in reporting income for the year in which the change occurred."

[22] Miller, supra note 8.

[23] Miller, supra note 12, at p. 1: "The fact that expenses were deducted by the farmer does not help the Bureau's position that income is realized by giving property away, if settled principles of tax law are observed. The income realized on sale or exchange of property has always depended on a comparison of the 'basis' (here zero) with the money or exchangeable goods received in exchange, and the profit so determined has never been affected by the fact that during the time the owner held the property he incurred deductible expenses in maintaining or protecting it."

[24] Reg. 111, §29.22(c)-3.

for charitable contribution.[25] He observes in a footnote that it should be possible to work out an adjustment of the inventory which will take the disposition of goods not sold into account.[26]

I must disagree with Dean Griswold as to the possibility of a double deduction. Under standard accounting procedure, required by accounting principles and enforced by the Treasury, the manufacturing corporation would credit (reduce) Cost of Goods Sold for the gift of inventory to charity (thus cancelling the increased cost of manufacturing resulting from the smaller closing inventory), and charge "Charitable Donations," or some similar account. It would therefore get one deduction only, that for the gift. If Dean Griswold were correct, a manufacturing furrier who gave his daughter a fur coat as a gift would get a deduction for tax purposes, since, as in the case of the gift to charity, closing inventory would be reduced by the cost of the coat.

One of the tax services follows Dean Griswold. In its Report of March 27, in which it discusses the *David C. White* case, supra note 10, it adds as a tax-reduction suggestion:

> "There seems no reason why the same break shouldn't be available to a commercial firm. Assume that a corporation manufactures a car which it gives to a charity. The car is to the manufacturer what the wheat is to the farmer. The corporation should be able to deduct all the costs of making the car plus the fair market value of the car. The Treasury will undoubtedly fight this in the same way it hits the farmer. However, if there is nothing to lose, it may be advisable to make contributions in products rather than in cash."

The tax service does not state in its discussion that the farmer was on the cash basis or that the manufacturer would necessarily be on the accrual basis; nor did it grasp that the manufacturer, unlike the farmer, does not deduct the costs of production as expenses, but that at all times the costs of production are carried on the books of the manufacturing corporation as an asset.

Miscellaneous

Dean Griswold, as a closely related problem, asks whether a manufacturer is allowed a double deduction if unin-

[25] Griswold, supra note 16, at pp. 84-85: "Suppose that a corporation is in the business of manufacturing widgets, and it has a large number of widgets in its inventory of completed goods. Under proper accounting practice, the cost of manufacturing these widgets will be included in the inventory valuation. It will thus increase the cost of goods sold during the year, and consequently decrease the corporation's gross income for the year, and thus its net income and tax liability. Now, the corporation actuated by laudable charitable motives, makes a gift of one hundred widgets to a charitable enterprise, which needs them badly in its activities. The widgets will be removed from the inventory, since they have been disposed of. The effect will be to reduce the value, and cost, of the closing inventory. The necessary consequences of this will be to reduce the gross income for the year.

"Since the widgets were given away, nothing will be included in the gross receipts on account of them, unless a principle like that involved in the two rulings already mentioned is applicable. Unless such a principle is applied, it seems clear here, as in the wheat case, that the taxpayer will get in effect a double deduction. He will be entitled to deduct all of the cost of producing the goods given away, as a business expense, or as an addition to inventory costs. And he will also be entitled to a deduction for a charitable contribution under Section 23(o) or 23(q). One way to obviate the effect of this double deduction is to require the inclusion in income of the fair market value of the items given away, at the time they are given. This is the method adopted in the Treasury rulings."

[26] Griswold, supra note 16, at p. 85, footnote 6: "It may be observed here that the inventory is simply an accounting device designed to enable a determination of the cost of goods *sold*. When goods have gone into the inventory, and are then disposed of in some other way than by sale, an argument can be made that the inventory device is no longer applicable. The determination of the cost of these particular goods is no longer relevant, since they were not sold. It should be possible, in such a case, to work out an adjustment of the inventory which will take the fact of the disposition of these goods into account; and such an adjustment would be wholly consistent with the basic objective and purpose of proper inventory accounting. This would seem to be simply an accounting matter, which could be appropriately handled by a proper provision in the regulations."

sured inventory is destroyed by fire.[27] The answer is that a manufacturer whose inventory was destroyed by fire would not be permitted to take a double deduction under the regulations.[28] If this is not sufficient authority, the Supreme Court has set its face sternly against double deductions. In *Charles Ilfeld Company* v. *Hernandez,* the parent company which had reduced consolidated income by a subsidiary's losses, did not reduce its basis for the subsidiary's stock on liquidation of the subsidiary by the amount of the loss deducted, thus seeking a double deduction.[29] The Supreme Court denied a double deduction, saying:

> "In the absence of a provision in the Act definitely requiring it, a purpose so opposed to precedent and equality of treatment of taxpayers will not be attributed to lawmakers."

Dean Griswold asks whether a taxpayer should be entitled to a charitable deduction for the fair market value of a machine with a zero basis which has appreciated in value because of changes in the price level and shortages of such property.[30] I can see no reason why a donor of appreciated machinery is any the less entitled to the deduction than is a donor of appreciated securities. The depreciation on the machine is part of the cost of producing the manufactured commodities in previous years. The gain on both appreciated securities and appreciated machinery used in the trade or business is capital gain under section 117.

Dean Griswold also asks as an undecided point whether when an owner of property mortgages it without personal liability for more than its cost there is any income in the transaction.[31] But the Tax Court had held eight months earlier in *Woodsam Associates, Inc.,* that the transaction was not a taxable event.[32]

Dean Griswold's Proposed Statute

Mr. Miller fears that, if it becomes settled that a taxpayer may make taxable income by giving away farm products which he has raised, donors of appreciated securities may be taxed on the appreciation at the time of the gift.[32a]

Dean Griswold has drafted a statute to eliminate the double deduction involved in deducting the full cost of producing an item and then taking its fair market value as a charitable deduction. To relieve Mr. Miller's fears Dean Griswold has also provided in his proposed statute that gifts of appreciated property to a charity are to be

[27] Griswold, supra note 16, at p. 88: "Suppose, for example, that uninsured property held in inventory is destroyed by fire or other casualty. Is the entire amount of the loss deductible under Section 23(e) or 23(f) of the Code? If not, why not? Yet, if the deduction of the full inventory value of the property is allowed, it is quite clear that there is a double deduction, a result which is really rather hard to justify."

[28] Reg. 111, §29.23(a)-1: "Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code cannot again be deducted under any other provision thereof."

[29] 292 U. S. 62 (1934).

[30] Griswold, supra note 16, at p. 89: "The problem may also arise with respect to depreciated property. Suppose that a person buys a machine for $1,000. He uses it for several years, and deducts depreciation in the full amount of $1,000. However, because of changes in the price level and shortages of such property, it has a fair market value of $1,500. Suppose he now gives the machine away to a charity. Should he be entitled to a deduction for a charitable contribution in the amount of $1,500."

[31] Griswold, supra note 16, at p. 89: "Finally, there is another situation to which reference should be made in order to complete the picture. This is the case where a person mortgages property for more than its cost, without personal liability, and then gives the property away. For example, suppose a person buys property for $25,000. It appreciates and becomes worth $100,000. The owner mortgages it for, say, $80,000, without personal liability. Is there income in this transaction?"

[32] 16 T. C. 649 (March, 1951) reviewed by the Court, now on appeal to the Court of Appeals for the Second Circuit. In this case the mortgage was foreclosed; the Tax Court held that the foreclosure was the taxable event.

[32a] Miller, supra note 12, at pp. 2 and 12.

deductible as contributions at their fair market value without increasing income. His suggested statute eliminates double deductions by adding a sentence at the end of sections 23(o)[33] and 23(q)[34] to provide that[35]

> Where the gift is of property, the deduction shall be in the amount of the fair market value of the property at the time of the gift, except that where the gift is of property which would be included in the taxpayer's inventory or is otherwise of property the proceeds of which would be fully included in gross income if the property were sold then no deduction shall be allowed.

Under this statute, however, a taxpayer who had securities with a zero basis would be denied any deduction for the charitable contribution. Also, since by a gift to charity a manufacturer does not get a double deduction, a manufacturer who made a gift to charity of inventory would be denied any deduction for the gift. Dean Griswold has spread his net too wide.

A Proposed Regulation

I think that the courts will hold if the point is presented to them that, since all taxpayers in the same position should be treated alike, a cash basis farmer who makes a gift of farm products raised primarily for sale should be treated the same as any other business man who makes a gift of products produced for sale. It is unfair to the farmer to consider the fair market value of such a commodity as income to him if he makes a gift of it; other business men would charge themselves and credit Cost of Goods Sold with only the *cost* of production. It is unfair to the revenue to permit him to deduct as a business expense the cost of producing the commodity if he gives it to charity or to a son. In fact, Treasury instructions to returns of farm income provide that a farmer may not deduct the cost of producing a commodity which he and his family consume.[36] Surely, it cannot be said that if the Treasury does not permit a farmer to deduct the cost of producing food he consumes it has acquiesced in his deducting the cost of production of gifts.

The amounts deducted in a year previous to that of the gift present a more serious problem in the unlikely event that the courts fail to require farmers to return to income the cost of production of gifts when the point is argued to them. But, since the use of the cash basis by farmers is a concession by the Treasury, the Treasury may by regulation attach as a condition to the concession that costs of production deducted in the current year or a previous year as an expense be returned to income in the year of the gift, whether the gift be to charity or to a son.

Such a regulation would make Dean Griswold's proposed statute unnecessary.

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[33] Allowing deductions for charitable contributions by individuals.
[34] Allowing deductions for charitable contributions by corporations.
[35] Griswold, supra note 16, at p. 92.
[36] Instructions to Form 1040F, "U. S. Schedule of Farm Income and Expenses": "The value of farm produce consumed by the farmer and his family need not be reported as income; but expenses incurred in raising such produce must not be reported as deductions."

The "Funds" Statement on the Cash Basis

By JOHN N. MYER

This is a rejoinder to the recently published comments on the author's previous article on this subject.

THE writer has shown[1] that a statement accounting for the variation in the cash balance between the beginning and end of a period may be arranged as follows:

Cash Balance, January 1, 1950			$ 4,261
Cash Was Increased By:			
Sales		$86,750	
Sale of furniture		664	
Loan from bank		7,500	
Additional investment by partners		4,000	
		$98,914	
Less—Increase in accounts receivable		2,778	96,136
			$100,397
Cash Was Decreased By:			
Purchase of goods for resale		$47,193	
Selling, general and administrative expenses		27,361	
Interest cost		405	
Withdrawals by partners		10,450	
Purchase of furniture		1,476	
Purchase of truck		5,000	
Repayment of bank loan		3,000	
		$94,885	
Add—Decrease in accounts payable	$228		
Decrease in accrued liabilities	111	339	
		$95,224	
Less—Decrease in prepaid expenses		177	95,047
Cash Balance, December 31, 1950			$ 5,350

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[1] Myer, John N. "The 'Funds' Statement" *The New York Certified Public Accountant*, vol. 21, pages 353-356, 358 (May, 1951).

It has recently been suggested that the above statement "can be restated, in far simpler fashion"[2] by arranging it in the following manner:

Cash balance, January 1, 1950		$ 4,261
Cash was increased by:		
Collection of accounts receivable	$83,972	
Sale of furniture	664	
Loan from bank	7,500	
Additional investment by partners	4,000	96,136
		$100,397
Cash was decreased by:		
Payment of accounts payable	$47,421	
Selling, general and administrative expense	27,184	
Interest	405	
Withdrawal by partners	10,450	
Purchase of furniture	1,476	
Purchase of truck	5,000	
Repayment of bank loan	3,000	
Payment of accrued liabilities	111	95,047
Cash balance, December 31, 1950		$ 5,350

The compiler of the revised statement has succeeded, as was his intention, in presenting it in "far simpler fashion" but he has done this by making assumptions of fact not given in the case, as follows:

(1) That the increase in accounts receivable was caused by sales of merchandise. The increase might have been caused in part by the sale of furniture.

(2) That the prepaid expenses which were decreased were "selling, general and administrative expenses" but they might have been some other kind.

(3) That the accrued liabilities which were decreased were not part of "selling, general and administrative expenses" which they might have been and, to be consistent in making assumptions, should have been there allocated. (One wonders what would have been done if the accrued liabilities had increased instead of having decreased.)

(4) That the decrease in accounts payable represents accounts that arose through purchase of goods for resale. But this decrease might have been in accounts payable for expenses or for the purchase of fixed assets.

It should be noted that if the title "payment of accounts payable" is to be used, it should include all payments and this would reduce the decrease in cash to one item, thus:

Payment of accounts payable	$95,047

Such procedure would, however, destroy the statement as a means of presenting a summary of the financial events that affected the cash during a certain period, which is its purpose as the present writer sees it.

[2] Gregory, Robert H. "The 'Funds' Statement Re-examined" *The New York Certified Public Accountant*, vol. 21, pages 755-757 (November, 1951).

Although the statement ostensibly reconciles the cash balance at the end of the year with that at the beginning, the object of its preparation is not to prove the cash balance. This is done in other ways in the process of auditing the books.

Obviously when information such as was assumed in preparing the "simpler" statement is available, the statement can be much improved. But since the information was not given, the assumptions were not valid.

The type of statement under discussion is unfortunately complicated by the adjustments necessary to convert the data obtained from the financial statements on the accrual basis to the cash basis on which the statement is prepared. The cash increase requires adjustment for changes in (1) receivables, (2) accrued income, and (3) deferred income. The cash decrease requires adjustment for changes in (1) payables, (2) prepaid expenses and deferred charges, and (3) accrued expenses.

Your Career Goes into Production

By HAROLD R. CAFFYN, C.P.A.

This address by a leader in our profession to a group of outstanding accounting students meeting with the Buffalo Chapter of our Society contains some sage, practical advice. Younger staff men would do well to read this paper carefully.

WE are sometimes apt to overlook the significance of events in which we participate. When the Buffalo Chapter of the New York State Society of Certified Public Accountants invited me to address this dinner at which their guests of honor were to be some of the outstanding accounting students in the local colleges, I was naturally flattered. As I began to think of a suitable topic for discussion however, the meeting assumed a far greater importance than I had originally recognized. It dawned upon me—and for a minute I am directing my remarks primarily to the accounting students—that I would be addressing a group having particular significance to those of us who are deeply concerned with the trend of world events today. For, despite the growing disposition to discount our free enterprise system and capitalism, you have embraced one of the purest forms of capitalism—embraced it of your own accord and with full knowledge of the facts. You have, moreover, backed the wisdom and soundness of your choice with your careers. I refer, of course, to the substantial capital investment you have made in yourselves. That investment is measured in relatively insignificant degree by the actual cash that it has cost you for tuition, maintenance, loss of income, etc., during the period of your training. It is measured far more significantly by the critical years of your life that you have devoted to your accounting and business training. It is in this role of capitalists then, that I address you today, and I am now including the practitioners present, for it is perhaps one of the outstanding characteristics of a real profession that it is composed of men who have been willing to make a capital investment in themselves.

My remarks are not intended to have application solely to those who propose to enter the profession of public accounting. They are based, it is true, on my experience in that profession, but most of them should apply to related fields in which you might become engaged.

Going back to the time of your original decision to be a capitalist, I am confident that you gave earnest thought to the selection of a suitable field for investment. You undoubtedly considered such factors as your own interest in and capacity for the work of your selected field, and you probably also studied the history of that field in order to satisfy yourself that its future seemed to hold a favorable market for your product. I believe that in professional accounting you have just that. If you want proof of the profession's growth, look at these estimates of the number of C. P. A's. in the United States:

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1900.....	250 C.P.A's.
1910.....	1,700
1920.....	5,000
1930.....	13,600
1940.....	20,000
1946.....	26,000
1951.....	40,000

If you question the future, just consider two statements made by the United States Department of Labor in connection with a recent study of the profession. "It is likely that employment opportunities for new graduates entering this field will improve greatly during the next few years" and "over the long run there is likely to be continued growth in the profession."

To bring the matter right up to date, listen to this from the April, 1952, issue of the Journal of Accountancy: "Shortage of qualified accountants focuses attention on talent now available. A new study by New York Society of C.P.A's. shows that desirable new employee is much different person from his counterpart twenty years ago, and harder to find."

Now let us look for a while at the balance sheet of your personal capital venture. It is very much like that of any other growth organization. Years of careful planning and investment have been charged to development expense account and now constitute the principal asset on the statement, offset on the other side by your capital account. You are exactly like many an airplane company, for instance, that has done a tremendous amount of research and tooling up in anticipation of the great day when production could begin. You are about to go into production. It is to be hoped that, with the passage of time, following the pattern of typical successful growth companies, two changes will occur in the balance sheet picture which will overshadow in their significance anything that is now shown on the statement. First, we trust, that a highly successful operation will result not only in satisfactory distributions but also in a steady and substantial increase in the earnings retained section of the statement. Secondly, it is reasonable to expect that success will encourage further investment in the enterprise with consequent increase in the capital accounts. It is with these two possibilities that I would like to deal this evening.

Turning first to operations and carrying forward the analogy with the aircraft manufacturer, we know from experience that, come production day, our preoccupations are not so much with what was planned, as with what was unanticipated. In other words, there seldom was successful production of a new product without a period during which "the bugs were ironed out."

This is primarily your enterprise. You are the one who will have to iron out the bugs before your operation is running smoothly. However, the experience of others may save you time. With this in mind I have reviewed several years of experience with men entering public accounting and have tried to identify the factors which seem most frequently to have caused failure or delayed success.

I believe that the two principal "bugs" encountered by those going into production in public accounting are "attitude" and "thinking processes."

Attitude

Let us deal first with Attitude. Heretofore, as a student, you have, in effect, been a buyer, a buyer of education who has enjoyed, strange as it may sound to you, the advantages of a buyer's market. As a public accountant you will become a seller with the likelihood that conditions over the long term will still be those of a buyer's market. You have, in fact, become part of a long selling chain, no part of which can long exist without the other parts. You have to sell yourself to your firm. You and your firm, in turn, have to sell yourselves to your client. Your client would not be providing you or himself with a livelihood unless he were selling himself to his customers—the public. The education you have been buying is part

of the capital you will now devote to that purpose. The transition from buyer to seller involves a major change in attitude.

This change has many facets. Previously, your own future should have been your greatest concern. Under the modified attitude I am suggesting, it would still be important but it would now become a by-product of service to the public through the chain of selling I have indicated, rather than a primary objective. Previously, you had to see that you *got* good value for your education dollar or your education hour. Now you have to see that you *give* good value for your salary dollar and employment hour. You will be able to recognize the professional attitude in yourself when you find that you are under self-imposed pressure to give more in service than you receive in salary.

Another facet of this basic change of attitude relates to your continued learning. Learning has been your primary object in the days behind you. It will always be very important. In fact, you would be a poor professional man if you did not expect to continue acquiring knowledge for the rest of your life. However, your fundamental purpose in the future will be service—service to your firm, to your profession, and to the public. Knowledge, and lots of it, will come to you as an incident to that purpose and I certainly hope that you will supplement that knowledge with organized study. However, this must be a secondary objective. You must be prepared to do your fair share of the jobs which involve little new experience—or even your disproportionate share of those jobs if the primary program calls for it. You must be ready, in addition, to disturb your plan of supplementary study for the same reason. Later, when obtaining your C.P.A. certificate may seem of supreme importance to you, such disruption may look like a very material sacrifice.

In these situations, I would ask you to keep constantly in mind that your employer's interest in your advancement in knowledge, experience, and stature is almost equal to your own. He will merely have had a little more experience in reconciling that objective with the practical, and partially conflicting ones, which now enter the picture.

Let us look at another aspect of the problem of attitude. You will do well to combine a good product with an appropriate degree of salesmanship. This involves something more comprehensive than merely the superior performance of your work. It has to be well packaged and effectively "put over." The problem is not simplified by the very proper restraints placed on us by our professional organizations and, more important still, by our own sense of good taste and propriety. However, it is entirely proper for you to assume immediately your share of the responsibility for leaving in the mind of your employer's clients the impressions:

1—that you regard yourself as a professional man;

2—that you are proud of the organization of which you are a member, and believe that it has something of real value to offer to its clients; and

3—that in that organization the junior, no less than the partner, accepts the problems of the client as his own.

These are impressions which can be conveyed only if they truly reflect your own attitude. Each man, once having adopted the underlying attitude, will convey them in his own way and according to his own habit and temperament. Dignity in personal appearance and bearing, responsiveness, real and alert interest in your current work are characteristics which go hand in hand with the attitude I have been describing. I can assure you that practice offers no greater satisfaction to us than to have a client go out of his way to say "What a fine group of fellows you sent over to us this year."

Before I leave this matter of attitude, there is one more point I would like to

make. Have confidence in your employer. If you haven't, get another. Your objective is presumably to be his partner eventually. You never can be unless you and he are working together to a common purpose. You have to convince him that you think of him in those terms and you may find yourself in competition with others who are trying to do the same thing, so the sooner you adopt that attitude the better start you have. You have a right, of course, to expect him to recognize your point of view, but make quite sure that you see his too. If you can't understand his actions, give him an opportunity to explain their motivating causes. You may find that they affect you just as much as they affect him. But if you never raise the question, you are not likely to discover that fact.

As I think over what I have said so far, I am afraid you may have gathered the impression that I came here to give you nothing but a lot of platitudes, generalities, and theories. I hope I can persuade you that in representing the employer's point of view as I may appear to be doing, I am, in a practical sense, trying to help you as prospective employees. Keep it in mind too that, in a profession, there is a far less clearly defined line of demarcation between employer and employee; after all, we think of the employee of today as the employer of tomorrow.

I am reminded of a talk I had many years ago with an architect of national repute. We were discussing the modern trend in architecture, the streamlining and simplification which is taking place, etc. He said something like this. "A very interesting thing is happening. We are beginning to find out that, if we concentrate on utility and pay less attention to design as such, the design appears to take pretty good care of itself." Something of the same situation applies, I believe, to what I have been saying to you. All the talk about ethics, professional approach, service, etc., may sound theoretical and idealistic to men like you who are faced with the practical problems of getting your careers into production. A significant point is, however, that they were developed as the result of experience by men who discovered, as did the architects, that the satisfying and the practical turned out to be one and the same thing. I believe that you, too, will find that these ideals represent, in fact, the most effective approach to even your materialistic objectives.

Thinking Habits

So far I have devoted myself largely to the adjustments in attitude. Now I would like to turn to an adjustment of even greater significance. An adjustment in thinking habits.

Up to the present your brain has been, as it were, "tooling up." It has been given practical problems in the laboratory, but only on a trial-run basis. It is now coming to the point where it is expected to operate and produce effectively and efficiently. This involves a fundamental difference in your thinking habits and the change is a real problem for some people. Let us look at some of the aspects of this change. First of all, debate takes on an entirely different character. Most graduates who come to us seem to have had fine experience in the analysis of a problem into its component parts, the listing of the pros and cons, and in discussion and debate thereon. We find, however, that a much smaller percentage of them come to us with the ability to recognize the point at which debate has served its practical purpose and decision must be reached. Too many are willing to continue debate *ad infinitum* and sometimes *ad nauseam.* Accounting practice involves the making of decisions under pressure of time. Debate becomes the means of arriving at the best decision, and not an end in itself—not a game in which the objective is to be the winner. This is basically, of course, a matter of judgment too, and judgment comes only from extensive experience applied to a sound theoretical base. Some men, however, acquire this habit of making

up their minds much more readily than others. Those that do, get off to a flying start in the practice of public accounting.

Having said that, I will take a big step backwards and come to the next point. Whatever you do, don't reach your judgment so quickly that your conclusions turn out to be more often wrong than right. The penalties for mistakes will have become somewhat more severe.

Another point that will influence your thinking habits is the decreasing finality of the answers you are likely to find in the future. It is true that great strides have been taken in making college work more practical through laboratory courses, etc. However, you have been largely dealing in the past with an area in which one answer has appeared to be right and another wrong. You are passing increasingly into the area where definite answers will be more difficult to identify. Moreover, in addition to considering the basic pros and cons of the case before you, you will have to weigh factors such as materiality and practicality. Sometimes, in fact, your answers will be compromises, although I assume that they will always be those of independent professional men. Nonetheless, your objectivity and independence will be strained by factors from which they have been entirely free in the past. This, too, is a new habit of thinking. Its early acquisition will be an important factor in your professional growth.

Still another important aspect of the change in thinking is one that perhaps I should have put first. As you go into production, the direction in which knowledge travels will tend to be reversed. The transition may not be immediate and will always take place within the bounds of your expanding responsibility. However, fundamentally, knowledge will start to travel upwards from you to your seniors, instead of downwards as in the past from your professors to you. Obviously, for years, and I sincerely hope forever, you will be gaining from the knowledge and experience of others, but this will be a by-product, the basic objective of your professional career being to pass on to others your own findings and experience. The change is sometimes a difficult one for the new junior to identify and to accept. You must bear in mind that, no matter how routine and simple your first assignments may appear to be, they are part of a program carefully designed to distill information for the partner who will eventually report to the client. His job will only be a good one to the extent that you, and others like you, are able to dig out the facts, to reach sound conclusions, and to pass them on to him, through whatever channels may exist, in concise, orderly, and reliable form. If you are successful in recognizing and accomplishing this objective, it will not be long before you move up the ladder yourself and will be helping others in their efforts to pass significant information upwards through you to those to whom you are still responsible.

Before leaving this question of responsibility for informing those above you, I would like to emphasize another feature of it. Because of the relative definiteness of answers to the questions with which you have been dealing in the past, the man with the dissenting opinion may have been interesting and provocative, but not too important. This is by no means the case in practice. Your minority opinion, or even your sole opinion, if it is a well considered one, is going to be of great importance in the future. You may be working in an area which no one else will see in detail. You will be the authority on that area. The supervisor may be standing twenty feet away from the financial haystack directing those who are looking for the needle in it. You will be in the middle of the stack—searching. If you feel a sharp pricking in your finger, don't be afraid to assume you have found the needle. Obviously, you're the only one in position to find it. Don't let any cynic convince

you too easily that the tingling sensation is just a nervous reaction. Check your suspicions. If you are satisfied that you've got a point—say so—and stick to it.

Now I would like to turn for a few minutes to the other side of your operating career. We will assume that the plant is running smoothly, the difficulties have been eliminated, and normal expansion is taking place. I suspect that the very characteristics which persuaded you to undertake the risk capital operation in the first place will again influence you. In other words, you will look around for effective ways of expanding, ways of building up and making additions to your capital accounts. This purpose has been accomplished traditionally in three principal ways. They all involve the same approach as did your original investment—willingness to back your faith in yourself with your time, your effort and your patience. I will state them briefly and discuss them. They are:

1—By enlargement of your field of usefulness to your organization through additional study and/or through specialization.

2—By participation in "extra-curricular" activities of a nature calculated to yield benefit from a long-range point of view.

3—Through participation in professional affairs.

Further Study and Specialization

Additional usefulness will come automatically and to a large extent, through the experience you gain in day-to-day practice. However, if you are to keep ahead of the crowd you will probably wish to augment that practical experience with organized supplementary study, and, as you have done before, prepare yourself for bigger things. The first step in this direction will, of course, be work leading to a C.P.A. certificate. What I am thinking of particularly, however, is the work that will come after that, and I suggest that it is never too early for you to start thinking about some field of specialization. I use that word with care. I do not mean specialization in one phase of work to the exclusion of others. I do mean, however, specific extra study and experience, supplementary to general practice, which will make you the man to whom the office turns when problems arise in your sphere of particular competence and training. Many of your seniors will have become so absorbed in the problems of general practice that they cannot specialize. That is just your good luck and your opportunity. No matter what your position on the staff, if you really have a field of specialization and it is needed, they will turn to you and be glad to get your help.

So begin to think about this possibility as soon as you can, bearing in mind that you are likely to be most effective in areas where your interest lies deepest. Therefore, look the field over pretty thoroughly before you take too definite steps in any direction. The possibilities are numerous. Despite all our efforts to identify the characteristics and mental make-up of the successful accountant, it must be recognized that the scope of general public accounting practice is so wide that it contains component parts which will appeal to men of almost completely differing likes and temperaments. Take auditing alone, for instance. Some men just seem to have a nose for an irregularity. When they catch the scent of irregularity they will worry at the underlying detail like terriers. It is by no means to be assumed that they are the men who are best at the thorough painstaking work involved in design or study of internal control. Other auditors find their greatest satisfaction in the niceties of statement presentation and assembly. They are not always those who do the best job of report writing and analysis. That's just part of the range of auditing. Then think of taxation. Even here the specialist is not easy to identify by type or interest. At one extreme you have men who are

successful through their ability to start with given facts and to find the best tax answer to them. Such men are by no means necessarily of the same type as those who have real enthusiasm for a proper and ethical influencing of the facts prior to their occurrence, to the end that taxation may be kept at a proper minimum. The born systems man is likely to be another breed entirely. And here again, the field is so wide that no one type is the ideal one, for you have costs, cost accounting, operating methods, accounting methods (including, today, occasional excursions into the field of electronics), manual writing, etc. Then there is the man who is a successful accountant just because he is a natural business leader with sound business judgment. Looking ahead you will have no difficulty in recognizing other fields of possible additional usefulness. There is a brief picture of part of the field that might receive your special attention. You are likely to be an ugly duckling indeed if there is no part of it in which you are able to make yourself outstanding.

Civic and Philanthropic Leadership

The second principal field I referred to as one for the development of capital surplus was that of "extra-curricular" activity. Don't cut it out entirely just because your back is nearly breaking under the strain of the other obligations I have described. The world will look to you, as a professional man, to make a contribution for the benefit of those less fortunate or less able to help. Interest yourself in civic affairs and, while you may follow conservative accounting practice by charging the cost to operations, I am sure that most successful practitioners will tell you that in the long run the substantial addition to goodwill will represent a material accretion to your capital account.

Professional Society Activity

Lastly, I would suggest that you think of your professional organizations as additional partners in the projects I have outlined above. Just as you and other alert staff members are in healthy competition with each other but close and friendly collaborators in pursuit of your firm's advancement, so, too, are we all—firms, partners, and staff members, serving a common professional interest and, beyond that, a public interest. The practitioners here tonight are already your partners in this purpose. They feel that they can advance it and benefit themselves more effectively through organization as a chapter. I would urge you to join that chapter as soon as possible, and by the same token, I would urge you to lose no time in associating yourself with your professional colleagues through membership in the New York State Society of Certified Public Accountants and in the national body, the American Institute of Accountants.

I have brought with me this evening, for those that want them, a supply of two booklets. They should not only be of use to you, but should also provide evidence of the community of interest which already exists between the profession and yourselves. One, published by the New York State Society of C.P.A.'s, gives a summary of opinions by representative C.P.A.'s concerning educational qualifications which prospective employees should have. The other, published by the American Institute of Accountants, deals with the C. P. A. examination.

In conclusion, I would like to give you just one short story. Not so many years ago some earnest young capitalists like you had a plane of their own making in what was little more than a garage. The production bugs weren't ironed out yet and they didn't have much money. They needed accounting advice, however, and called on us for help. They were where you are today, just at the corner leading to production. They are still clients of ours. Their planes are now to be seen all over the world. As I think over what I have been trying to say to you this evening, I realize that the problems they overcame are very much like those you now face. Well, gentlemen, what are you waiting for?

New York State Tax Forum

Conducted by BENJAMIN HARROW, C.P.A.

Employees' Trust

Under the Internal Revenue Code, and under the State income tax law as well, a trust set up for the exclusive benefit of employees forming part of a pension plan is not subject to tax on its income. Amounts actually distributed or made available to distributees are taxable to them in the year such amounts are made available, and such amounts are taxable to the extent that the payments exceed the amounts paid into the fund by the employees. The tax treatment of such payments follows the rules reflecting annuities: 3% of the cost of the annuity (the amount contributed by the employee) is taxable; the balance is a return of the cost. Once the entire cost has been recovered, any additional payments become fully taxable. The federal and state rules are the same on this treatment of pension payments.

Suppose an employee receives his total distributions from the trust fund all in one year, as he might if he left his employment, would the entire distribution be taxed as ordinary income? Under the Internal Revenue Code such a distribution would be considered a long-term capital gain and taxed as a capital gain. There is no similar provision under the State income tax law, and one of our members suggests that the State, in the interest of equitable treatment of its taxpayers, should adopt such a rule.

The federal government usually takes the lead in easing the burden of taxpayers in meritorious situations and this is certainly one of the situations that should receive the favorable consideration of the State Tax Commission.

In the 1951 Revenue Act Congress made the burden of the taxpayer easier in another phase of the pension trust. If the total distribution consists in whole or in part of securities of the employer corporation, the net unrealized appreciation of such securities will be excluded from income in the year of distribution, and will not be taxed until such time as the securities are sold. This is a fair provision since the tax should accrue preferably when the realization of gain is in the form of cash. No such rule is found in the State income tax law and this, too, should receive the attention of the Tax Commission.

Capital Gain Dividends

Under Section 362 (b) (7) of the Internal Revenue Code, a shareholder of a regulated investment company may treat a capital gain dividend as a long-term capital gain instead of ordinary income. A regulated investment company is a domestic corporation which is registered under the Investment Com-

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Mr. Harrow has been a member of the American Institute of Accountants since 1922 and is a member of the New York Bar. He is now serving on the Society's Committee on Federal Taxation, and is Chairman of its Committee on State Taxation. He is also a member of the Institute's Committee on Federal Taxation and its Council.

Mr. Harrow is engaged in practice as a certified public accountant and attorney in his own office in New York City.

pany Act of 1940 as a management company or a unit investment trust. To qualify for the favorable tax treatment provided, it must come within the provisions of Sec. 362 (b), which provide that 90% of the gross income must be derived from dividends, interest and gains from the sale of securities; less than 30% of the gross income can be derived from the sale of securities held for less than three months. There are additional requirements relating to the nature of the assets that may be held by the investment company. If such a corporation distributes as taxable dividends other than capital gain dividends, not less than 90% of its net income during the year, such income is not subject to normal or surtax. In addition, distributions out of capital gains may be treated as capital gains by the shareholders. No similar provision is found in the New York law. One of our members suggests that a similar provision should be enacted by the State.

Unincorporated Business Tax—Allocation

An individual is a piano-tuner by trade. He carries on his activities as an independent contractor residing part of the year in New York and the balance of the year in Florida. Several questions are asked concerning his New York State tax liability. Is he subject to income tax on his Florida income? Is such income subject to the unincorporated business tax?

If he is a resident of New York he is subject to income tax on all of his income from all sources. This of course will include his Florida income. As a non-resident he will be subject to income tax only on his New York income.

A piano-tuner is engaged in a trade or occupation the income from which would be subject to the unincorporated business tax. Piano-tuning in our opinion would not be considered a profession exempt from this tax. However, this taxpayer would be permitted to allocate his income since he maintains places of business within and without the state. In our opinion, a piano-tuner could consider his home a place of business, assuming he had no other formal place of business. This taxpayer therefore would be subject to the unincorporate business tax only on his New York income. He would also be entitled to the specific exemption of $5,000, plus a deduction in arriving at net income for a salary for himself. This deduction may not exceed 20% of the net income before the deduction and in no event may it exceed $5,000.

Unincorporated Business Tax—Officer of Several Real Estate Corporations

One of our members asks if an individual who receives a "salary" from a number of real estate corporations is subject to the unincorporated business tax on these salaries.

The unincorporated business tax is imposed on any trade, business or occupation that may be conducted by an individual. He is not deemed to be engaged in an unincorporated business with respect to compensation for services rendered by him as an employee, nor as an officer of a corporation. (Sec. 386)

However, the Tax Commission may look into the nature of what is denominated salary. For example, if the compensation is really a payment for acting as a broker or for other services performed as an independent contractor, then this individual would not be considered an employee and he would be subject to the unincorporated business tax. Not so long ago, the court held[1] that two individuals associated as salesmen for two furniture companies were not individual employees of the two companies but were a partnership subject to the unincorporated business tax. They promoted sales by their own methods and efforts. They did not perform their services in an

[1] *People ex rel. Feinberg et al.* v. *Chapman*, 274 App. Div. 715 (1949).

office maintained entirely by the employers and they were not accountable to the employers as to the method in which they carried on their affairs and the results obtained.

Unincorporated Business Tax—Allocation

In the February issue of the State Tax Forum[2] we discussed the three factors employed in the apportionment of income subject to the unincorporated business tax. One of our members asks why I did not mention "the fourth factor." He calls it "the invisible one, namely the 100% purchase factor."

If the factor method is to be used there are only three factors, real and tangible property, wages and salaries and gross sales. It should again be noted that the law permits an allocation on the basis of the taxpayer's own books, provided they are "so kept as regularly to disclose the proportion of the business income which is owned within the state . . . " The Tax Commission must however approve the taxpayer's method.

Our member probably had in mind a provision in Sec. 386-g and in question and answer 77 of the Regulations. There is a fourth method mentioned in the answer to question 77. This reads as follows:

> "If the foregoing methods do not allocate a fair and equitable proportion of the net income of the unincorporated business to the state, such net income shall be allocated in a manner prescribed by the Tax Commission."

Under the equitable powers held by the Tax Commission it may introduce other factors or eliminate one or more factors. When additional factors are introduced they may consist of purchases or expenses, depending upon the type of business being conducted. If, for example, the purchase of merchandise is a vital New York factor which should be considered in order to arrive at an equitable allocation the Tax Commission may include purchases as a fourth factor. If all the purchases were made in New York that factor would then be allocated 100% to New York. There is nothing invisible about this factor. For that matter there might even be a fifth factor, expenses, for example.

The important point concerning allocation under the unincorporated business tax is that an apportionment may be made on the taxpayer's own basis and this method is the first one mentioned in the law. Such an allocation is not permitted under the franchise tax law although it should be.

Income Tax—Proration of Exemption of Husband and Wife

Husband and wife were married on May 1st. Both were single before May 1st. What is the personal exemption on a joint return and on separate returns? For the period to May 1st each spouse would be entitled to an exemption of 4/12 of $1,000.00 or $333.33 each. For the period from May 1st to December 31st, the exemption would be 8/12 of $2,500.00 or $1,666.67 for both husband and wife. On separate returns the exemption of $1,666.67 may be divided between husband and wife in any way they choose. Assuming separate returns are filed and the husband takes the entire exemption for eight months, his total exemption would be $2,000.00. On the wife's separate return her exemption would be $333.33. The exemption to which husband and wife are entitled for the period before they were married may not be divided between them on separate returns. Only the marital exemption may be so divided. On a joint return the total personal exemption would be $2,333.33.

One of our members calls our attention to the fact that one of the tax services in illustrating the proration for the personal exemption says that the entire exemption of $2,333.33 may be divided between husband and wife, whereas our illustration in New York State Income

[2] Page 129.

and Franchise taxes[3] says that only the marital exemption may be divided. According to Sec. 362 of the law, it would seem that our illustration is correct and the tax service is in error.

It should be noted that under the Internal Revenue Code there is no longer any provision for prorating personal exemptions and the exemption for each person is $600. For husband and wife it would be $1,200, the exemption for two persons.

Income Tax—Deduction for Taxes

Deputy Commissioner Kassel ruled recently[4] that the following local taxes are deductible from gross income:

(1) Retail sales and compensating use taxes.
(2) Taxes on sales of food and drink in restaurants.
(3) Taxes on consumption or use of utility services.
(4) Taxes on admissions, dues and membership fees.
(5) Taxes on occupancy of hotel rooms.

These taxes are all imposed upon the purchaser, user or consumer and therefore come within the provisions of Reg. 47, allowing a deduction for taxes imposed expressly against the person claiming the deduction. The vendor who collects the tax is also personally liable for the tax but his liability is secondary. It is imposed to guard against his failure to collect the tax from the person primarily liable.

Income Tax—Gain on Sale of Residence

The 1951 Revenue Act excludes from income tax a gain resulting from the sale of a residence if the taxpayer purchases a new residence within one year before the sale or one year after the sale, and the cost of the new residence equals or exceeds the selling price of the old residence. The New York legislature recently passed a similar law, but this was vetoed by the Governor on April 3, 1952. We call this to the attention of our readers for the reason that we have had several inquiries as to the New York law on this question.

Head of a Family Status

A taxpayer may obtain this status if he maintains a home in which he supports at least one dependent. Until the law was changed by the present legislature, such a taxpayer not only received a personal exemption of $2,500 but in addition he received a credit of $400, for each dependent. This credit for dependents has been changed by a bill that has been signed by the Governor and which becomes effective on March 31, 1952, for taxable years commencing after December 31, 1951. The credit for one dependent will be disallowed if a taxpayer has a status of head of family based upon dependents for whom he would be entitled to a dependency credit.

Medical Expense Deduction

The law allows a deduction for extraordinary medical expenses. There are several limitations on the amount that may be deducted from gross income. The first limitation is that only expenses in excess of 5% of net income before taking this deduction are to be considered. The second limitation provides that the maximum medical deduction for any year may not exceed $1,500 in the case of a joint return filed by husband and wife and in the case of a head of a family filing a separate return; for all other taxpayers the maximum deduction is $750.

One of our members would like to know how the maximum deduction is computed in a case where one spouse dies during the taxable year. Neither the law nor the regulations cover this

[3] Page 367.
[4] March 27, 1952.

situation. In our opinion the Tax Commission will allow a proration of the exemption based upon the change in status of the taxpayer on the same principle as the personal exemption is prorated. For example if the wife died on April 1st and the husband's status for the balance of the year was that of a single man the maximum exemption could be 3/12 of $1,500 plus 9/12 x $750 or $937.50.

Deduction for Charitable Contributions

Under the Internal Revenue Code the deduction for charitable contributions is limited to 15% of adjusted gross income. Net capital gains are included in adjusted gross income. Under the State income tax law capital gains are separately taxed and are not included in gross income. Consequently, a taxpayer who has had substantial capital gains and who has made substantial contributions may be severely limited as to the amount of deductions for State tax purposes.

Several members have called our attention to this inequity in the law. It would seem that the deduction for charitable contributions should be allowed against capital gains as well as ordinary income, subject only to an over-all limitation of 15%. To the extent not deductible against ordinary income the deduction should be allowed against capital gains. The Tax Commission should consider this suggestion in making its recommendations for changes in the law for the next legislature. The loss in revenue would be insignificant, particularly when compared with the encouragement given to philanthropic impulses.

Limited Recognition of Gain in Corporate Liquidations

Generally, a liquidation of a corporation is treated by each shareholder as a sale or exchange with a resulting capital gain or capital loss. The cost of the stock is measured against the fair market value of all the assets received by the stockholder to determine the gain or loss. One advantage in a liquidation is that the stockholder receives a distribution of the corporate surplus through the medium of the corporate assets and is subject only to a capital gain tax, whereas normally a distribution of the surplus is taxed to the stockholder as ordinary dividend income. Even a liquidating dividend may result in an onerous capital gain tax, particularly where the assets distributed are capital assets which have appreciated in value and the tax must be paid in cash. To facilitate corporate liquidations, especially in the case of holding companies and in the case of corporations seeking to avoid a double tax resulting from the sale of fixed assets, the Internal Revenue Code, in Sec. 112(b)(7), provides a special method of liquidating a corporation which particularly avoids the capital gain tax on appreciated assets. An analogous provision was introduced in the State income tax law by the recent legislature. The bill was signed by the Governor and became effective on April 12, 1952.

Under Section 354, sub. 9 (a), of the New York income tax law, property may be distributed by a corporation in a complete liquidation with a limited recognition of gain under the following conditions: The liquidation must be made according to a plan of liquidation adopted after December 31, 1950. The distribution in complete liquidation and transfer of all the property must occur within some one calendar month in 1951 or 1952. Each qualifying shareholder must agree in writing to the entry of a judgment against him at any time (if he abandons his residence in New York) for the amount of tax that would have been due in the year of liquidation upon that portion of the assets received and upon which the gain has remained unrecognized. Under this agreement the stockholder must also waive his rights under the statute of limitations (Sec. 543 of the Civil Practice Act).

Only non-corporate shareholders of any class of stock may elect to qualify under this section. They must be shareholders at the time of the adoption of the plan and make written elections to obtain the benefits of this section and to be subject to immediate tax if they abandon their New York residence. For the plan to be operative as to any qualified individual stockholder, at least 80% of the total combined voting power of all classes of stock entitled to vote must file written elections. Voting power possessed by stock owned by corporations is excluded from the 80% computation. The filing of written elections must be made on or before December 31, 1952.

Each qualified electing shareholder is first taxed on his ratable share of the earnings and profits of the corporation to the extent of part of his gain as if he had received an ordinary dividend. The earnings and profits are determined as of the close of the month in which the liquidation occurs, without any reduction for distributions made during that month. This provision is similar to Sec. 112(b)(7) of the Internal Revenue Code.

Any additional gain is taxed as capital gain if it is represented by money or securities acquired by the corporation after August 15, 1950, and the gain exceeds the ratable share of earnings and profits. The gain on any other assets received is not recognized until it is realized by the shareholder in a subsequent sale of the asset.

Impact of Section 354.9a on Dissolutions of Real Estate Corporations

On April 24, 1952, our Society held a Technical Meeting devoted to aspects of the franchise tax. A month before there was a technical meeting on the income tax. Both meetings were unusually well attended. One of our members wanted to know whether the new provisions of Section 354 applied to the 2% dividend tax on the liquidation of real estate corporations.

Under Sec. 182 the excess of the fair market value of real estate distributed on dissolution over the cost is deemed to be a surplus and the 2% dividend tax on the distribution of this surplus is assessed against the corporation. Sec. 354.9(a) is an income tax provision and affects only the stockholders. The 2% tax would still be applicable.

If a stockholder taxpayer had filed his income tax return for 1951 and had received a distribution in a liquidation that qualifies under the new provision of Sec. 354 without considering the modified tax provisions it would be in order for him to file an amended return for 1951 and a claim for revision of his tax. He would be entitled to a refund if he had paid this original tax in full.

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Notes on the New York State Unemployment Insurance Law

Conducted by SAMUEL S. RESS

Voluntary Coverage

The New York State Unemployment Insurance Law has been further amended by Chapter 728 of the Laws of 1952.

An Employer of fewer than 4 persons, or an Employer exempt from the tax by law, may voluntarily cover his employees for Unemployment Insurance purposes to be effective as of the 1st day of any calendar quarter. Formerly, he was required to become covered from the 1st day of January of any calendar year. The law continues to exclude from coverage (even on a voluntary basis) agricultural labor, the services of an Employer's wife, husband or minor child, or employment subject to the Federal Railroad Unemployment Insurance Act.

Another amendment (Chapter 496) requires the payment of Unemployment Insurance Taxes to the State without permitting Unemployment Insurance benefits on the wages of part-time students, golf caddies and certain stockholder employees, provided the Employer has at least 8 covered employees and is subject to the Federal Unemployment Tax on such payments.

The State has announced that a special annual report will have to be filed in January covering this portion of the payroll. It is *not* to be included in the regular quarterly form IA-5 report.

The applications for voluntary coverage may be filed on or before the last day of the calendar quarter in which the coverage is to start. It formerly had to be filed on or before June 30th of the calendar year. The voluntary coverage election may now be for the unexpired portion of the calendar year and the following calendar year instead of "... for not less than two calendar years...."

Successors may elect predecessors' coverage within 30 days following the end of the calendar quarter in which the acquisition took place. Where an Employer is not otherwise required to continue coverage, his application for termination of coverage now may be made on a quarterly basis.

Experience Rating Initial Account Balances

Under the old law an initial account balance was available to any qualified Employer who was required to and filed by December 1, 1951, all contribution reports prescribed by the Commissioner, beginning with the 1st quarter of 1947 to and including the 1st quarter of 1951. The initial account balance was established as of July 1, 1951, if the firm had paid all contributions due. The law was amended to permit initial account balances to be established as of June 30, 1952, for all Employers who were required to file reports for the 1st quarter of 1952 and for any period prior to July 1, 1951. This balance was to reflect the position of the Employer's account as of July 1, 1951.

SAMUEL S. RESS has been an Associate Member of our Society since 1936, and is also a member of the Bar. He has specialized in the payroll tax field since the inception of this type of legislation in 1936.

Dr. Ress is a member of the Society's Committee on Clothing Manufacturing Accounting and on Labor and Management.

Joint Accounts

The establishment of joint accounts has been limited to Employers in a related trade, occupation or business or having a common financial interest. Joint accounts established prior to July 1, 1951, may be dissolved upon the filing of an application by one or more of the Employers included in such joint account. With respect to transfer of accounts for experience rating purposes, a provision has been added that no transfer shall be deemed to have occurred unless either the transferring Employer or the transferee has given notice to the Industrial Commissioner prior to the end of the calendar year following the calendar year in which the transfer occurred.

Limitation of Collection of Contributions, Interest and Penalties

The old law required that enforcement by civil action or by the issuance of a warrant for collection of contributions due from an Employer must be commenced within 4 years from the last day of the calendar year in which the wages were paid. The 4-year Statute of Limitations did not apply if the Employer had failed to file the wage reports required or he had filed a false wage report with intent to defraud. The law has been amended so as to provide that the enforcement of payment of contributions, penalties, or terms of extension agreements may not be commenced more than 2 years after a notice of determination thereon. However, if a tax warrant which has not been paid, has been filed in the County Clerk's Office, then the Statute of Limitations on the judgment is 15 years. The amendment also sets a six-year limitation on fixing an Employer's liability and on fixing the amount of back taxes due, except in case of fraud.

Joint Employment

A decision handed down on March 7, 1952, by the Appeal Board in Appeal Board cases #24,596-50 and #28,774-51, held that the Industrial Commissioner erred when he charged part of the wages and salaries paid to the employees of the N Corp. against the payroll of the A Corp. The Industrial Commissioner made such an allocation because he claimed that N's officers and its staff of employees had performed services for the A Corp., pursuant to an agreement entered into between the officers and directors of the two Employers. The facts in the case were as follows:

Employers A and N were domestic corporations and covered by the Unemployment Insurance Law since January 1, 1936. In 1938, N acquired all of the capital stock of A but each corporation continued to function independently of the other, operating separate plants, offices and its respective business. Each Employer kept separate books, payroll records, bank accounts, and filed separate Federal Income, Withholding and Social Security reports. Each corporation paid Unemployment Insurance contributions based on its own payroll. The directors and officers of the two corporations were not identical, but were interlocked. In contrast to the separate operating plants, the over-all general administrative offices of the interlocking officers and directors and their respective administrative staffs were housed in the same premises.

During the war, A's manufacturing and contracting activities expanded rapidly and A found itself unprepared to handle its administrative problems. As a result, it was agreed between the N Corp. and the A Corp. that certain administrative departments of Employer N would perform required work for Employer A. A agreed to pay N for the services performed by N's staff of employees and officers for A's benefit. These services were performed at N's offices, but no specific time was allocated to A's problems nor were any of N's employees transferred to or assigned work exclusively for A. The officers and their respective staffs during the course of the working day and

from time to time performed services for either N or A. Through its supervisory personnel and Board of Directors, N continued to direct and control those officers and employees who were performing services for A.

N rendered its bill for each month that services were performed for A. The directors used a percentage formula applied against N's cost of operations for the purpose of charging A. To the sum of the amounts chargeable to A, N added 4 percent for Social Security taxes and two pre-determined amounts to cover N's overhead costs. Later, the monthly charge was fixed at a flat sum each month. The books of both the A Corp. and the N Corp. were audited and, based on the report of the Payroll Examiner, the Industrial Commissioner issued an assessment against A in the sum of $3,470 for additional contributions and a credit to N Corp. of $1,106. Each Employer objected to the determinations and requested a hearing. The Referee sustained both determinations and Employer A appealed. The Appeal Board modified the decisions of the Referee. It was conceded that the N Corp. paid contributions due under the Unemployment Insurance Law on the first $3,000 of remuneration received by the officers and employees who performed the services. The Industrial Commissioner contended, however, that the monthly charges for administrative services paid by A to N represented a part of the total remuneration that N paid to its employees and that therefore A was liable for contributions to the Unemployment Insurance Fund on that portion of the remuneration paid by N to its employees in excess of the first $3,000 of remuneration, limited however to the 2nd $3,000 to each employee.

The Appeal Board found that no part of the lump sum monthly bills for administrative services paid by A to N represented an identifiable salary or wage of any particular officer or employee. On the contrary, the lump sum bills included a charge for N's overhead expenses including rent and bookkeeping services. There was no evidence that N had ever relinquished control over its administrative employees nor was there any evidence that A at any time had the exclusive use of the services of the employees who from time to time performed work for either Employer Corporation.

The Appeal Board stated:

> "Viewed in the light of the arrangement made between the officers and directors of the 2 corporations, we concluded that the administrative staffs and the employees were, during the period in issue, N's employees". . . .
>
> " . . . The ruling has long been that so long as an employee is furthering the business of his general employer by services rendered to another, there will be no inference of a new relationship unless command has been surrendered, and no inference of its surrender can be drawn from the mere fact of its division (*Irwin* v. *Klein*, 271 N.Y. 477) ... *Matter of Fulton Ship Operators P & I Service, Inc., et al.*, 273 App. Div. 614 . . . "

The Appeal Board held that the Industrial Commissioner's determination that A was liable for additional contributions in the sum of $3,470 was to be reduced by deleting therefrom the amount of contributions charged on the remuneration paid by N to its administrative officers and employees.

The Industrial Commissioner's determination that N is entitled to a credit of $1,106 for excessive contributions paid was modified by deleting a credit for contributions paid on remuneration earned by its administrative officers and employees.

Office and Staff Management

A forum for the exchange of views and information on all aspects of the administration of an accounting practice.

Conducted by MAX BLOCK, C.P.A.

Advice to Clients Re Life Insurance Uses

It is acknowledged that furnishing business advice is one of the major means of entrenching an accountant with his clients. A subject of great importance to business men, as to which accountants can be helpful, is that of life insurance planning for the retirement of a deceased stockholder's shares, with the object of making it possible for a survivor stockholder to acquire control and provide continuous harmonious management. The availability of such treasury stock for sale to "key-men", whenever desired, may be of greater value to the company than the existence of useless stockholders.

Up to about a year ago, such action by a corporation was fraught with tax dangers. However, considerable clearing of the atmosphere has resulted from a decision of the Circuit Court of Appeals holding that a life insurance plan for the purchase by a corporation of a deceased stockholder's shares serves good and valid business purposes, and is of benefit to the company. (*The Emeloid Co., Inc.* v. *Comm.*, CCA3). The Circuit Court reversed the Tax Court's non-business purpose decision and made such a good case for the company's position that it is likely to withstand further attack, if any.

Accountants have an opportunity to recommend, where practical, the use of corporate funds for life insurance premiums for stock retirement purposes, consistent with state laws. Such action may relieve tax anxieties as to large surpluses, provide borrowed-capital excess profits credits where loans are made to finance premiums, and, of equal importance, conserve individual resources by not requiring their use for stock purchases.

A careful analysis of the *Emeloid* decision, and discussion with client's counsel, will be helpful in dealing with this subject.

Bulletins to Clients

As clients increase in number certain procedures become practical and desirable. An innovation worthy of consideration is the issuance of a periodic bulletin to clients on sundry and diverse matters related to accounting, taxes, management, etc. This is a goodwill builder and is another means of making the accountant an indispensable adjunct of business .

A monthly "News Letter" of an accounting firm, dated June 1, 1951, was recently submitted to this department. It is a one-page affair, comprising nine concise paragraphs, each with a caption. The material dealt with was of the following nature:

1. Warning that tax deductions for travel, entertainment, repairs, and personal expenses are now more critically viewed than ever.

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2. Avoidance of 50-50 support of a dependent, for income tax purposes.
3. Comment on the *Emeloid* case and possible benefit to corporate clients.
4. Reminder to bring fire insurance (business and home) up to realistic values.
5. Warning that the Administration may increase third-class postal rates.
6. Other tax points.

Spiral Bindings for Reports

Anyone reading an accountant's report must contend with the problem of flattening it out to be able to read the material therein. In a report of many pages this is not easily done.

Some accounting firms are using a plastic spiral binding to improve report-handling convenience. This binding permits the report to lie absolutely flat when open at any page. The binding is a simple matter and is done by a machine that will not tax office space. The binding can be opened to permit the replacement of a page. While this is a convenience in instances where a correction must be made, it raises a question as to possible abuses after the report has been transmitted.

The views of readers on this subject would be welcome; also as to experiences with the physical aspects of the binding.

Improvement in Report Writing

This subject has been receiving increasing attention from accountants and accounting educators. In the May, 1952, issue of the *Journal of Accountancy* (p. 589) there appears a prize-winning program for the improvement of standards of staff in report-writing techniques. The program contains suggestions for small and large staffs and is worthy of review by those interested in the subject.

Some improvement can be achieved by making available to staff members model report forms containing paragraphs covering usual and routine report text material. This will not alone insure the use of good language and form but will also achieve uniformity, if that is considered desirable.

Mailing Returns to Tax Department

Some accountants engage in the practice of asking clients to sign tax returns and mail them to the accountants for transmittal to the tax department. This is done in the interest of insuring timely filing.

If, in such instances, a number of returns are mailed in one envelope the postage must be based not on the total weight but on the requirement for each individual return. Improper mailing may cause a delay and result in the very condition that is to be avoided.

The Excess Profits Tax Exchange

Conducted by DAVID ZACK, C.P.A.

THIS column is a clearing house for questions, problems and comments regarding Excess Profits Taxes. Items of general interest will be published herein and full credit will be given all contributors unless they request otherwise. All inquiries and contributions should be addressed to:

Editor, The Excess Profits Tax Exchange
The New York Certified
Public Accountant
677 Fifth Avenue
New York 22, New York

Acquisition of Stock for Cash in Part II Transactions

Section 462(j)(1) of the Internal Revenue Code may serve to deprive many taxpayers of the earnings experience of component corporations prior to the date of the acquisition of the stock of the component for cash or other assets. The section provides that:

"If, after December 31, 1945—

(A) the taxpayer acquired stock in another corporation, and thereafter such other corporation became a component corporation of the taxpayer, or

"(B) a corporation (hereinafter called 'first corporation') acquired stock in another corporation (hereinafter called 'second corporation'), and thereafter the first and second corporations became component corporations of the taxpayer, then to the exent that the consideration for such acquisiton was not the issuance of the taxpayer's or first corporation's, as the case may be, own stock, the average base period net income of the taxpayer shall be reduced, and the transferred capital addition and reduction adjusted, in respect of the income and capital addition and reduction of the corporation whose stock was so acquired and in respect of the income and capital addition and reduction of any other corporation which at the time of such acquisition was connected directly or indirectly through stock ownership with the corporation whose stock was so acquired and which thereafter became a component corporation of the taxpayer, in such amounts and in such manner as shall be determined in accordance with regulations prescribed by the Secretary. For the purposes of this paragraph, stock which has, in the hands of the taxpayer or first corporation, as the case may be, a basis determined with reference to the basis of stock previously acquired by the issuance of the taxpayer's or first corporation's, as the case may be, own stock, shall be considered as having been acquired in consideration of the issuance of the taxpayer's or first corporation's, as the case may be, own stock."

This provision of the law was enacted solely in order to prevent a duplication of excess profits credits. Without this provision, a taxpayer could use cash or other assets, representing capital with its own base period earnings experience, to purchase stock in a corporation which has a good earnings credit and thereafter acquire the latter's experience credit in addition to its own by means of a Part II transaction. However, there are many situations when the acquisition of stock in a component after December 31, 1945,

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for a consideration other than its own stock does not result in a duplication of excess profits credits. Thus, where the funds for the acquisition of the component's stock stems from a fresh stock floatation or the borrowing of new money, there is obviously no duplication and this section does not apply. The regulations seem to recognize this distinction and practitioners should be careful to analyze their own specific fact patterns before applying Section 462(j)(1) of the Internal Revenue Code.

Installment Basis and Long Term Contract Taxpayers

The current excess profits tax law gives installment basis and long term contract taxpayers the invaluable advantage of hindsight. These taxpayers may retroactively elect, in any excess profits tax year, to compute their net income, for excess profits tax purposes, for all excess profits tax years, on the accrual method and percentage of completion method, respectively. The statute of limitations cannot bar claims for refund and deficiencies under this retroactive election until two years after the election is made.

The election is irrevocable, once made, and applies to all excess profits tax years. It would therefore seem prudent to await the expiration of the current Excess Profits Tax Act before making the election. Claims for refund may be filed for the earlier years within two years after the election is made notwithstanding the effect of any statute of limitations.

The election for installment basis taxpayers is solely for the purpose of excess profits taxes. It might be expedient, in some situations, to change to the accrual method for income tax purposes as well. This change cannot, of course, be made retroactively and requires the permission of the Commissioner of Internal Revenue. A careful study of the specific fact pattern of each situation would be required in order to determine the feasibility of this procedure.

The present law requires that base period as well as excess profits tax years be recomputed on the accrual basis. Deductions limited by income are recomputed as are net operating losses. Bad debts are recomputed on the accrual basis. This recomputation of the base period net income in no way affects the regular normal and surtax for those years or any other years.

Any income resulting from installment sales made in years ended prior to July 1, 1950 is not subject to excess profits tax.

The burden of proof in connection with the computations involved in these elections is on the taxpayer. This burden may prove particularly onerous to long term contract taxpayers who wish to convert retroactively to the percentage of completion method since many detailed records are required to support this computation.

BOOK REVIEWS

(Continued from page 328)

Excess Profits Tax Course and Guide

By H. Kenneth Marks. WASHINGTON PUBLICATIONS, INC., New York, N. Y. Three volumes, pages: xciv + 651; $30.00; monthly supplements for one year, $25.00 additional. (Photo-offset)

Much has been written about the myriad mazes of the current excess profits tax law and now these encyclopedic volumes present a detailed roadmap to help guide the embattled practitioner towards the solution of his excess profits tax problems. As the title suggests, these books are intended to serve a dual purpose, each of equal importance: (1) a full detailed course of study in the excess profits tax law and (2) a reference manual which may be useful to the active practitioner in the course of his daily work. The job is well-done and should be eminently successful on both counts.

The course of instruction, intended primarily for home study work, is well laid out and should appeal equally as much to the neophyte as to the more seasoned practitioner. The language is simple and clear and the text is replete with many detailed and clarifying examples. The work is scholarly and fully annotated to the Internal Revenue Code, the Bureau of Internal Revenue's Regulations and pertinent court opinions decided under the World War II Excess Profits Tax Law. The material is of necessity often complex and cannot be read in a vacuum. It would take a rigorously disciplined mind to wade through these three volumes without the inspirational requirements of a formally organized course meeting regularly, but the material is certainly available for the ambitious student, be he at home, office, or classroom.

The Guide lends itself particularly well for research work for the practitioner with a special problem to solve. It has a unique four-way indexing system which should prove very helpful to the busy practitioner to whom time is very much of the essence. Each one of these indices is complete and self-contained and covers all the material in the three volumes from its own special perspective. First, there is a detailed table of contents. The principles of the excess profits tax law are set forth in sixteen chapters, which are in turn subdivided into paragraphs. Each paragraph is numbered, titled in explanatory terms and presented in logical sequence. These paragraph explanatory titles are reproduced at the top of every page of explanation and are very helpful. A study of this detailed table of contents will very often yield the clue for the solution of the specific reference problem.

Secondly, this Guide provides an index reference from each line of every page of the official Schedule EP to the text material. This index should prove invaluable inasmuch as the Bureau of Internal Revenue has done a masterful job of condensation and presentation in the preparation of the Schedule EP, and many of the practitioner's specific problems will arise in connection with the preparation of the Schedule EP. This particular index will enable the Guide to be used as a vastly expanded set of instructions for the preparation of the Schedule EP.

The third indexing method used by the Guide is the usual detailed subject-matter index. This index is alphabetically arranged and is sufficiently itemized to provide the key to the answer to most special problems. The last index is a cross reference of all Internal Revenue Code and Regulation citations to the text.

The Excess Profits Tax Course and Guide incorporates all the excess profits tax changes enacted by the Revenue Act of 1951 and all the Regulations promulgated to date. The publishers contemplate the issuance of special monthly supplements for the ensuing twelve months to keep the reader up-to-date on all new developments.

This reviewer cannot refrain from noting that there must be something inherently defective about a taxing system which requires three full volumes to present an explanation of a subchapter of a chapter of the Internal Revenue Code. Many systems of philosophy and science have been presented most effectively in far fewer pages. The fault, it must be emphasized, is not with Mr. Marks, but with the Congress, and that is where the remedy must be found.

DAVID ZACK

New York, N. Y.

Taxation and Business Concentration

Symposium conducted by the TAX INSTITUTE, INC., Princeton, N. J., 1952. Pages: viii + 264; $5.00.

Taxation is a dynamic field embracing as it does legal, constitutional and economic problems. This symposium volume attempts to analyze one aspect of the economic problem, the effect of our tax structure in fostering greater business concentration. Economists concerned with the problem of business and industrial concentration, as well as students of the federal tax law concerned with the

general problem of inequitable tax treatment embodied in our present tax structure, will find the book interesting. The participants in the symposium program are distinguished educators, attorneys, financiers, and accountants. Their articles are on the whole brief, critical, and penetrating.

The opening chapters are devoted to a general study of concentration trends with a somewhat detailed analysis of the tobacco and general retailing industries. The conclusions reached are far from startling; that federal income taxes are ostensibly nondiscriminatory, but that pre-1951 corporate rates afford favorable tax treatment to large established enterprises by penalizing small and medium-sized companies still in the process of growth. Unfortunately, the symposium was held before enactment in 1950 of the complex and vitally important excess profits tax, and before the change in the Revenue Act of 1951 of the corporate notch provisions. This rapid change in corporate tax events will probably throw out of focus the entire discussion. To rectify this failing, the editors have inserted in the concluding chapters an article by Beardsley Ruml on the discriminatory effect of the excess profits tax. Mr. Ruml's contribution on the subject, a discussion of six pages, is far too vague and far too incomplete to be of any analytical value.

The effect of the federal tax policy on retention of earnings and business growth is developed in Part II of the volume as a collation of papers on what appears to the reviewer to be a superficial and over-simplified study of Section 102, the government's depreciation policy, and the carry-forward and carry-back provisions of the Internal Revenue Code. The citations of federal statutes and regulations and the interpretative case law on the subjects might at times be more explicit.

Part III presents a discussion, not wholly free of rancor and bias, of the competition posed by tax-exempt business enterprises. The three articles on cooperatives, one pro and two con, are of unusual interest in illustrating the general hostility of private business to cooperative concepts. While outwardly the participants are analyzing tax theory, the two articles attacking cooperatives present nothing more than an economic defense of private enterprise. The lone defender of tax exemption for farm cooperatives is critical of the general contention that tax exemption granted to cooperatives fosters concentration in business, without fully developing the reasoning leading him to the criticism, although he does cite quite liberally informative statistics on cooperative growth and development.

The concluding parts of the volume present a more practical discussion on specific tax provisions which would have an obvious effect on business concentration. Problems of capital gains, the double tax on dividends, estate, inheritance and gift taxation and their integration with our social and economic policies are briefly explored.

As a primer for the general economic effect of taxes on business concentration the book is particularly helpful. For those interested in further research, the book offers an excellent bibliography. Although the participants in the symposium have not attempted a minute analysis of the subject, the study as presented is stimulating, for nearly all of them believe that our present tax structure has some undesirable economic effects on business even though they show wide disagreement on the significance and extent of such effects.

SAMUEL A. DYCKMAN

New York, N. Y.

Uniform System of Accounts for Hotels (1952 Edition)

As prescribed by the American Hotel Association of the United States and Canada, and the Hotel Association of New York City, Inc. HOTEL ASSOCIATION OF NEW YORK CITY, INC., New York, N. Y., 1952. Pages: vii + 107; $3.50.

The 1952 edition of the Uniform System of Accounts for Hotels is the fifth since the Uniform System of Accounts for Hotels was inaugurated in 1925. Twenty-five years ago the methods of hotel accounting were almost as numerous as the number of hotels. There was no uniformity, and each hotel had its own peculiar methods of recording and presenting financial data.

Because of these divergences of ideas, a committee was appointed to discuss the possibilities of uniformity. The committee consisted of the auditors of several individual hotels, the partners of public accounting firms particularly interested in the hotel industry, and representation from both the New York State Society of Certified Public Accountants and the American Institute of Accountants.

The basic principles and financial statements developed in the first edition of the Uniform System of Accounts for Hotels have remained throughout the years. It is a tribute to the hotel industry that it has seen fit to review the Uniform System from time to time and adopt modern accounting methods, at the same time keeping abreast of changing business conditions. In 1950, the Hotel Accountants Association of New York City decided that a thorough review of the Uniform System of Accounts for Hotels would be advantageous. Accordingly, a committee was appointed consisting of representatives of two of the public accounting firms primarily interested in hotel accounting, and three well-experienced auditors from hotels. The com-

mittee immediately requested suggestions and ideas from the various hotel accountant associations throughout the United States. The suggestions received by the committee, as well as the ideas of the members of the committee, were thoroughly discussed, and certain recommendations made which were referred to the American Hotel Association, The New York State Hotel Association, and the Hotel Association of New York City for consideration. Committees were appointed by the respective associations which reviewed the recommendations of the committee of the Hotel Accountants Association of New York City and there finally emerged the revisions incorporated in the 1952 edition.

There were changes made both in the balance sheet and the profit and loss sections. The balance sheet was revised to give effect to the accounting principles set forth in Accounting Research Bulletin No. 30 issued by the Committee on Accounting Procedure of the American Institute of Accountants in regard to the present day concept of current assets and current liabilities. The policy set forth in the bulletin of the American Institute has become generally accepted procedure in financial circles, and it was felt that the hotel industry should conform to this bulletin.

Most of the profit and loss accounts, and a large part of the method of statement presentation have not been changed, but there have been some important revisions which will be discussed here. One of the most important features incorporated in the 1952 revisions is the provision for making a complete segregation between food and beverage operations. In previous editions there has been segregation of sales, and cost of sales, as well as segregation of those expenses which are directly charged either to food or beverages, but there were certain income and expense items which were classified as "joint" (applicable to both food and beverages) which were not allocated between food and beverage operations. In the study of the subject of entirely segregating the food and beverage operations it was found that there has been a persistent demand by hotel management for financial statements showing food operations distinct from beverage operations, and as a result of this requirement, the segregation had already been made in many hotels.

The Uniform System has now been revised so that provision is made for this segregation of food and beverage operations so as to comply with the needs of management and others who have use for this information. While certain expenses applicable to both food and beverages must be allocated, it was felt that this could best be done in an equitable manner by each hotel after a study of its particular situation. Even though the manner of allocation cannot be made the same for all hotels (as it would not be equitable due to circumstances of each situation), the uniformity of reporting the operations has been retained; the Uniform Sysem remains intact, but each hotel still can have a segregation of food and beverage operations consistent with its particular circumstances.

Another important revision in the current edition of the Uniform System of Accounts for Hotels is the provision for distribution of payroll taxes and employee relation expenses among the various departments. Expenses of this nature have become so burdensome, and are such an important percentage of payroll cost, that it was found desirable to distribute these expenses to the various departments so that the cost of the payroll and related taxes would appear as direct charges in the cost of operating the department. The distribution of payroll taxes and employee relations expenses would be made on the basis of taxable payroll and the other factors which would give an equitable distribution to the various departments. Sugestions in regard to allocation are set forth in the revised Uniform System.

The term Capital Expenses has been eliminated in the new edition of the Uniform System. In place of the obsolete term Capital Expenses, there will be a breakdown into four divisions: Rent, Municipal Taxes and Insurance; Interest; Depreciation and Expense Amortization; and State and Federal Taxes. It was the consensus that these new titles would be more descriptive of the expense accounts previously included in the over-all term Capital Expenses.

In addition to the foregoing major changes, there are a number of minor changes such as the name of the Porter Department, now termed Transportation Department; provision for further sub-classification of expenses included under Repairs and Maintenance; elimination of certain expense classifications which are no longer applicable; changes in titles of certain expense accounts so as to be more descriptive of the nature of the items included therein, and creation of new expense classifications of incidental nature.

Among the suggestions made to the committee was the recommendation that consideration be given to the distribution of "overhead" expenses to the income producing departments. These "overhead" expenses consist of administration; advertising; heat, light and power; and repairs. This suggestion was discussed at length. It was finally decided that no formula for distribution of "overhead" expenses could be developed which could be generally applied and found equitable for use by all hotels. On the other hand, there has been sufficient demand for allocation of "overhead" expenses that the committee felt some action should be taken. Accordingly, there is a section in the revised 1952 edition which sets forth some pertinent data to accomplish this objective including

some suggestions as to methods of allocation. The System has been arranged so that the distribution of "overhead" expenses is optional, and if distribution is desired, the allocation may be made in subsidiary schedules after preparation of the accounts and financial statements in the basic uniform manner. This arrangement was made so that the benefits of the Uniform System would be retained, and yet would permit of the distribution of "overhead" expenses.

It was the feeling of the committee that over a period of a few years, certain basic methods of distribution of "overhead" expenses among the operating departments will evolve, and it is possible that certain uniformity of distribution might be established at a later date.

THOMAS J. HOGAN

Harris, Kerr, Forster & Co.,
New York, N. Y.

Elementary Accounting

By Perry Mason, George B. Stenberg and William Niven. THE FOUNDATION PRESS, INC., Brooklyn, N. Y., 1951. Pages: x + 653, plus 278 pp. of problems; $5.50.

The distinctive features of this first-year college text are its lucid, clear presentation and the balance it achieves in the development of each topic. The language is simple, and yet the coverage is complete. Topics are developed to a point which may be termed elementary, and yet sufficient theory is injected to make the subject matter understandable and meaningful to the beginning accounting student.

The authors use the balance sheet approach. The sequence of subject matter is for the most part orthodox. The text consists of twenty-eight chapters. The first fourteen chapters are concerned with basic concepts, the various possible arrangements of journals and ledgers, and the steps that make up the accounting cycle. The second fourteen chapters are subdivided into the following phases: The problems and theories of classification, valuation, and general treatment of assets, liabilities, and corporate capital; partnership formation, operation, and dissolution; introductory cost accounting, consisting of job order and process costing, and cost allocations under various situations; published financial statements; and financial statement analysis and interpretation.

Throughout the text, the authors make use of charts and diagrams for the purpose of making the presentations visual. The accounting equation, for example, is effectively developed through the medium of diagrams. The work sheet is developed by adding successive segments indicative of the stage of completion. The first illustration shows the trial balance before closing, the next one adds the adjustments pair of columns, and the final one adds the adjusted trial balance, profit and loss, and balance sheet pairs of columns. Cost flow charts are used frequently in the chapters on cost accounting. Whenever sequential procedures are involved, the steps to be followed are listed.

Particularly refreshing to the reviewer were two chapters entitled, "Controlling Accounts and Special Journals," (Chapter 8) and "Payroll Taxes and Sales Taxes," (Chapter 9). These two chapters should be of particular appeal to junior accountants. Chapter 8 demonstrates the different methods of handling accounts receivable and accounts payable. The authors illustrate the posting to subsidiary ledgers from journals and from underlying business forms as alternate methods. They also explain how the files may serve as subsidiary ledgers.

The chapter on payroll and sales taxes contains the various tax return blanks, forms, and records used in payroll accounting and reporting to the federal government. One of the minor dangers in furnishing these forms is the possibility of their becoming obsolete. Thus, the authors' reproduction of Form 940 for the annual federal unemployment insurance tax is now out of date due to a revision effective with the year 1951.

As is true of all texts, the work under review is found wanting in certain minor respects. The discussion on the preparation of interim statements is skimpy. Also, a more substantial philosophical base is needed for the development of the statement of funds. Again, judging from the positive statements on pages 372-373, the authors are adherents to the cost basis of inventory valuation. This position is somewhat surprising, in view of the "future utility" or "cash realizable" concept which has been adopted by the public accounting profession.

On the whole, the text is a worth-while addition to the string of elementary accounting works published since World War II. This text, in the reviewer's opinion, is entitled to a high rank in the list of such works.

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Operating Results of Department and Specialty Store Branches (Bul. No. 136)

By Milton P. Brown. DIVISION OF RESEARCH, HARVARD BUSINESS SCHOOL, Boston, Mass., 1952. Pages: 70; $2.50.

Similar to Harvard's annual study of operating results of department and specialty stores, this book covers a study of the operating results of both branch department stores and branch specialty stores. The data upon which the report is based were gathered in two questionnaires sent to stores throughout the country, one in 1949 (covering 1948) and one in 1951 (covering 1949 and 1950). Like other publications of the Division of Research of the Harvard Business School, this study is technical and contains a wealth of information both in the text and in the many tables included therewith. In contrast to Harvard's annual study of department and specialty store operating results which many people have come to use primarily as a reference work, this study dealing with branches should be read in order to appreciate the scope and significance of its findings. While the tables are as usable as those in Harvard's other reports, their significance will not be grasped readily, in the reviewer's opinion, without first reading the text.

In the introduction, Mr. Milton P. Brown points out that while some department and specialty store branches were established more than a quarter of a century ago, no complete or comprehensive study of their operating results has ever been published. He adds, however, that in recent years when it has become apparent that branch stores will play an important role in distribution, the desire of retailers for such a study has been very keen. Mr. Brown found out in his preliminary work that branch store operators were thirsting for figure data but that as a group they had not agreed upon what data were most critically needed or what the best solutions were to some of the policy problems they had encountered. The Division of Research was handicapped by the lack of standardization of accounting in branch stores and by the significant differences from store to store as to the form in which figures were collected and presented.

In Part I, comparisons are made of the operating results of branch stores with those of their own parents as well as with those of independent department and specialty stores of similar size. Part II is devoted to an examination of the trend of merchandising and operating results of branch department and specialty stores for a three-year period including comparisons with independent stores of the same type and size as the parent of the branches. This latter approach is an attempt to answer a question of most managements, namely, "What effect did our branches have on our competitors?" In Part III an effort is made to ascertain the effect of sales volume upon branch store margin, expense and profit. The last major section of the book, Part IV, correlates the branch operating results with the location of the branch in relation to its parent. In other words, what effect does the location of the branch have upon its operating results?

It is to be regretted that uniform methods of accounting had not been devised prior to the undertaking of his pioneering study. Apparently there is no uniformity in such matters as the allocation of mark-downs between main stores and branch stores nor in the methods of allocation of expenses. Under the circumstances, the study has tried to answer many questions by a comparison of firms without branches and firms that do have branches.

To attempt, in this review, to summarize the findings as outlined by Mr. Brown would be to over-simplify a highly technical study which should be read in its entirety to appreciate the author's summary which covers the last section of the book. The study, in the reviewer's opinion, should be required reading for all those in retail management who now operate branches or who intend to acquire them.

J. P. FRIEDMAN

New York, N. Y.

The Accountancy of Changing Price Levels

Published by THE INSTITUTE OF COST AND WORKS ACCOUNTANTS, LTD.; distributed by GEE & CO., LTD., London, 1952 (Copyright). Pages: main work—129 pp.; abridged version—24 pp.; prices—15s. and 2s. 6d., respectively, post free.

Increasing attempts have recently been made to focus attention on the serious effects of inflation on the capital resources of business enterprises. Present circumstances have emphasized this aspect of what is the general problem of the effect on industry of changing price levels.

In conditions of fluctuating prices the real capital of a company instead of being maintained may be reduced through the claims of taxation and the distribution of dividends. Moreover, the results of business operations on which managers and proprietors base decisions and policy, are not recorded in terms of real values. These effects are the result, on the one hand, of basing taxation and dividend policy on money profits without regard to the trend in real profits. And they are the result, on the other hand, of the use by managers and proprietors, of accounting information—that is, financial statements and operating statements of various kinds—drawn up in terms of money values which again conceals the true trend of results.

Thus, price fluctuations have a serious effect on accounting procedures based on the conventional treatment of original money values. The usefulness of accounting information presented in this way is gravely impaired at a time when management's need of precise and accurate information about the real economic trends in the business is most urgent. In fact, some doubt exists whether the use of present accounting techniques can produce information that is free from the bias of fluctuating prices.

The question arises, therefore, whether accountancy can meet this challenge and allow for the influence of price fluctuations in the calculation of results and profits and presentation of operating statements. The Research and Technical Committee of the Institute of Cost and Works Accountants has investigated the problem and has now published two works on the results of their studies: *Accountancy of Changing Price Levels*, a form of text book which discusses the subject in great detail; and an abridged version intended for higher management, financial directors and others who are concerned with the problem but not its details.

These publications contain proposed accounting principles which if employed will give management information that will show, *inter alia:*

(a) How much profit must be retained in a business to finance the replacement of its existing assets;

(b) Whether the real value of capital originally contributed has been maintained continuously during the life of the business and whether the real profits earned have increased, decreased, or remained constant; and

(c) The financial position of a business in terms of current money values.

Two sets of principles are outlined in the reports. One set is to be followed in accountancy to insure that real capital is being maintained by calculating and disclosing in accounting statements the effects of changing prices on the real profits of an enterprise.

The second set comprises those principles to be followed so that the results of business transactions are calculated and disclosed in terms of comparable values by converting original costs—out of phase in terms of time—into current costs. Although the present problem in industry mainly concerns rising prices, both sets of accounting principles outlined are applicable in conditions of falling prices.

It should be noted that the Research Committee has not attempted to examine the effects of the procedures recommended on current taxation theory and practice. Nor has it attempted to state the case for modifying tax law and practice, which is beyond purview of the Committee. What has been attempted is the drawing up of a series of accounting principles which will meet industrial management's present urgent need of accounting information free from the bias of changing price levels. To a large extent what is advocated is an extension of a trend in accounting techniques which is already apparent in many of the procedures of cost accounting.

Proceedings of New York University Decennial Institute on Federal Taxation (November 7-16, 1951)

Edited by Henry Sellin. MATTHEW BENDER & COMPANY, INC., Albany, N. Y., 1952. Pages: xv + 1384; $23.50.

The publication of this book marks the completion of a decade of cooperative education in the field of taxation, conducted under the auspices of the Division of General Education of New York University by a distinguished group of accountants and attorneys, who are recognized authorities on federal taxation. This tenth volume contains sixty-eight papers on twelve different aspects of the subject, ranging from the general to the particular. The subjects covered are the following:

Tax Problems Relating to Real Property, Tax Problems of the Individual, Excess Profits Taxes, Taxes and the Operating Business, Problems of Specific Industries, Practice and Procedure, Tax Aspects of Estate Planning, Developments in Tax Legislation, Conduct of a Tax Practice, Stockholder and Corporation, Reorganization: Parent and Subsidiary, and Fraud Problems. Also included are a Table of Statutory References, a Table of Treasury Regulations References, and an Index.

This series of volumes deserves an honored place in the library of every tax practitioner.

Standard Chart of Accounts For Newspapers

INSTITUTE OF NEWSPAPER CONTROLLERS & FINANCE OFFICERS, New York, N. Y., 1951. Pages: 16; $10.00.

This standard chart of accounts for newspapers is the result of three years' study and research by the Technical Advisory Committee of INCFO, and represents the best features of many now used by various individual newspapers. Haskins & Sells, CPA's, cooperated in the undertaking. It may be used to advantage without regard to the size of the enterprise, and its use should result in greater uniformity in accounting methods and reports. Accountants whose work takes them into this field would do well to familiarize themselves with this document.

Lieutenant Stanley T. Adams Medal of Honor

ONE BITING-COLD FEBRUARY NIGHT, Lieutenant Adams was on a bitterly contested hill near Sesim-ni, Korea. Out of the dark earth the silhouettes of some 150 Communist troops rose up against the skyline. Ordering fixed bayonets, the lieutenant, with only 13 men, leaped up and charged furiously against the overwhelming odds. He was knocked down by a bullet. At least three hand grenades actually bounced off his body before exploding nearby. But when Adams and his squad were through, there were only 50 Communists left on the hill—and they were dead.

"Nobody likes to kill," says Stanley Adams. "Nobody likes war. But today the surest way to invite a war is to be weak. You and I know that twice in the last ten years Americans have let their guard down. And the Philippine and Korean graveyards are filled with men who paid the price for it.

"Please don't make that tragic mistake again. Remember that in the world today, *peace is only for the strong*. Help make your country and your armed services stronger still —by buying more . . . and more . . . and more U. S. Defense Bonds. Put *your* bond-power behind *our* fire-power, *now*—and together we'll keep America at peace!"

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Remember that when you're buying bonds for national defense, you're also building a personal reserve of cash savings. Remember, too, that if you don't save *regularly*, you generally don't save at all. Money you take home usually is money spent. So sign up today in the Payroll Savings Plan where you work, or the Bond-A-Month Plan where you bank. For your country's security, and your own, buy United States Defense Bonds now!

Peace is for the strong... Buy U. S. Defense Bonds now!

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